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Report of the Auditor General of Canada to the House of Commons

Chapter 29
Industry Canada – Management of the
Small Business Loans Program

December 1997



Communication Publications

Report of the Auditor General of Canada to the House of Commons

Chapter 29
Industry Canada – Management of the
Small Business Loans Program

This December 1997 Report comprises 16 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, October and December 1997 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.



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# **Chapter 29**

**Industry Canada** 

Management of the Small Business Loans Program The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Assistant Auditor General: Richard Flageole Responsible Auditor: Harry A. Ruthnum

## **Industry Canada**

# Management of the Small Business Loans Program

#### **Main Points**

- 29.1 Small businesses play a very important role in our economy. In 1994, more than 98 percent of all businesses in Canada were small businesses with fewer than 50 employees. In 1995, small businesses contributed 43 percent of Canada's private sector economic output. However, the lack of financing on reasonable terms and conditions has often been identified as a significant barrier to the growth of small businesses.
- 29.2 The objective of the Small Business Loans Program is to increase the availability of loans for establishing, expanding, modernizing and improving small business enterprises. New lending under the Program will end on 31 March 1998 unless the government decides to renew it. This presents an opportunity to better define the results expected from the Program and to improve performance measurement. As part of the decision to renew the Program, it will be important to take into account the needs of small businesses in a changing Canadian economy and business environment. The dual objectives of increasing the availability of loans at reasonable rates while recovering all the costs need careful analysis.
- 29.3 The Small Business Loans Program will incur a net loss estimated at \$210 million for loans issued between 1993 and 1995. The Program is now moving toward full cost recovery; however, under the present fee structure and loss-sharing ratio, it is uncertain whether full cost recovery will be achieved. Careful monitoring and better systems to forecast the future performance of the Program are needed.
- 29.4 Industry Canada requires lenders to comply with the *Small Business Loans Act* and Regulations and to exercise due care when making loans. The Department needs to strengthen its claim audit procedures to obtain assurance of such compliance. It also needs to take steps to minimize the interest it is paying on claims submitted by lenders. The intent of the Act regarding lending to related borrowers requires clarification.
- 29.5 It is important that the Department provide Parliament with the information necessary to assess whether the Program is managed efficiently and is achieving its objectives. In addition, more rigor is needed in evaluating the Program's impact on job creation.



## Introduction

## Small businesses make a significant contribution to the Canadian economy

29.6 In 1994, more than 98 percent of all businesses in Canada were small businesses with fewer than 50 employees. In 1996, one out of two Canadians was employed in a small business. Moreover, it is well recognized that small businesses account for a greater share of employment creation than their share of existing employment.

29.7 Small businesses play a very significant role in our economy. In many regions of Canada, they are at the heart of economic activity and community development. In addition, they sometimes develop into large firms of the future. Small businesses contributed 43 percent of Canada's private sector economic output in 1995.

29.8 Management experience, market access, availability of financing, application of technology, and fiscal and monetary policies are all important factors that contribute to the success of small businesses. Financing, however, is vital for a small business, particularly in its early years. Typically, the initial capital comes from the owner or from family and friends. Much of the additional equity comes from the earnings of the business. The other significant source of financing is through borrowing, primarily from the chartered banks, caisses populaires, credit unions and trust companies. The lack of financing on reasonable terms and conditions has often been identified as a significant barrier to the growth of small businesses.

29.9 Governments in industrialized nations have traditionally played an important role by offering financing and/or guarantees to improve access to capital, with the objective of creating jobs and stimulating economic growth. As well, governments have become involved

in small business financing to counter the negative effects of downturns in business cycles. One of the initiatives that the federal government has introduced to achieve these objectives is the Small Business Loans Program.

29.10 The Small Business Loans Program is one of several federal programs aimed at providing assistance to small businesses. For example, some programs of regional development entities, and the Farm Improvement and Marketing Co-operative Loan Act are designed to cover lenders' losses on loans to small business. The Business Development Bank of Canada also provides direct financing to small businesses. Two provinces have programs that are similar to the Small Business Loans Program.

## Objective and operation of the Small Business Loans Program

29.11 The Small Business Loans Program was established in 1961 to provide loan guarantees to private sector lending institutions. The Program aims at encouraging lenders to make loans, on reasonable terms and conditions, for the establishment, expansion, modernization and improvement of small business enterprises, by offsetting a portion of the lenders' net losses in the event of default of a guaranteed loan. The Program is well known among the small business community and financial institutions. Exhibit 29.1 outlines the main changes to the Program since its inception in 1961 to the latest revision in 1995. The Program is subject to a sunset clause and has been renewed many times since 1961 for specified lending periods. New lending under the Program will end on 31 March 1998 unless the government decides to renew it.

29.12 Guaranteed loans are available to all businesses with sales not exceeding \$5 million, with the exception of farming, religious and not-for-profit organizations. The maximum amount that can be loaned

The lack of financing on reasonable terms and conditions has often been identified as a significant barrier to the growth of small businesses.

under the Program at any time is \$250,000 per borrower. This amount can be used to finance up to 90 percent of the purchase or improvement of land, buildings and equipment. The maximum repayment period for a loan is 10 years. Small business loans are not available for acquiring shares; purchasing inventory, goodwill or intangible assets; financing working capital; or refinancing existing debt.

29.13 Lending institutions make loans directly to borrowers and are responsible for all aspects of credit management, including realizing security pledged against a loan if the borrower defaults. Lenders are allowed to obtain personal or corporate guarantees. The personal guarantee is unsecured and cannot exceed 25 percent of the loan amount. Borrowers pay an up-front fee of two percent of the amount borrowed at the time of the

#### Exhibit 29.1

Major Changes to the Small Business Loans Program

1961	Creation of the Program.					
	The Program was delivered by the Department of Finance.					
	Chartered banks were the only eligible lenders.					
	The maximum loan amount was \$25,000.					
1970	Credit unions, caisses populaires and other co-operative societies, trust, loan and insurance companies became eligible to lend.					
1971	• Eligible small businesses were defined as businesses with less than \$1 million in revenues.					
	• The maximum loan amount increased to \$50,000.					
1974	The Province of Alberta Treasury branches were added as eligible lenders.					
1977	• Eligible small businesses were defined as businesses with less than \$1.5 million in revenues.					
	• The maximum loan amount increased to \$75,000.					
1978	The responsibility for the Program was moved to the Department of Industry, Trade and Commerce.					
1980	The maximum loan amount increased to \$100,000.					
1985	• Eligible small businesses were defined as businesses with less than \$2 million in revenues.					
	A 1% registration fee was introduced.					
1993	• Eligible small businesses were defined as businesses with less than \$5 million in revenues. Firms in particular sectors (including the professions) became newly eligible.					
	The maximum loan amount increased to \$250,000.					
	• The percentage of financing permitted increased to 100% from 80% on equipment and 90% on land and buildings.					
	• The maximum rate of interest increased to prime plus 1.75% from prime plus 1%.					
	• The amount of government guarantee increased to 90% from 85%.					
	The registration fee was increased to 2%.					
1995	• The percentage of financing permitted was reduced to 90% (for loans made after 31 December 1995).					
	• The maximum rate of interest was not to exceed prime plus 3%.					
	A 1.25% annual administration fee was introduced.					
	• The amount of government guarantee for lenders was reduced to 85% (for loans made after 31 December 1995).					

registration of the loan guarantee. Lenders pay an annual administration fee of 1.25 percent on the average monthly outstanding balances for loans issued after 31 March 1995. This administration fee may be passed on to borrowers through an increased interest rate. In the event of default of a guaranteed loan, the Program pays to the lender 85 percent of the net amount in default. The maximum loan loss that can be reimbursed to an individual lender is generally limited to 10 percent of all its guaranteed loans registered. Rates charged by lenders cannot exceed prime plus three percent for a floating rate loan, or applicable residential mortgage rates plus three percent for a fixed rate loan.

29.14 The Small Business Loans Administration Directorate of Industry Canada is responsible for loan guarantee registrations, for ensuring that lenders and borrowers comply with the Small Business Loans Act and Regulations, and for processing lenders' claims for loans in default. It had a staff of 35 and an administrative budget of \$2.3 million in 1996-97. The Department's Entrepreneurship and Small Business Office provides overall strategic direction for the Program.

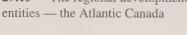
29.15 The regional development Opportunities Agency, the Federal Office of Regional Development - Quebec, and Western Economic Diversification Canada — are charged the respective costs incurred by Industry Canada for claim payments, net of fee revenues, made within their jurisdictions.

#### The level of activity has increased significantly since 1993

Important amendments to the Small Business Loans Act were implemented in 1993 to broaden eligibility criteria, increase the amount of financing made available and reduce personal guarantee requirements. Further amendments were made in 1995 to reduce the percentage of financing permitted and the loss-sharing ratio, to introduce an annual administration fee and to increase the maximum rate of interest. As shown in Exhibit 29.2, the level of activity increased dramatically in the two years that followed the 1993 amendments and diminished thereafter.

29.17 In the last four years, some 177,000 new loans have been guaranteed for a value of approximately \$11.2 billion. The 1997 federal Budget increased the authorized ceiling for loans that can be issued from \$12 billion to \$14 billion. The total amount of guaranteed loans outstanding at 31 March 1997 was \$6 billion, of which the government was

Since 1993, some 177,000 new loans have been guaranteed for a value of approximately \$11.2 billion.



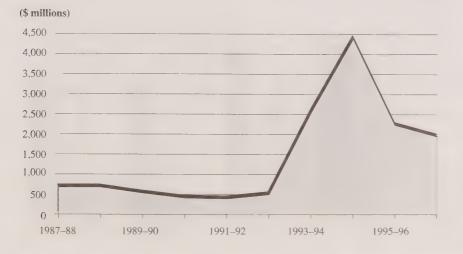


Exhibit 29.2

Value of Small Business Loans Act (SBLA) Loans Issued, by Fiscal Year

Source: Industry Canada SBLA Database The Program is generally used to finance new and early-stage enterprises.

In 1994, concerns were expressed about the increasing costs of the Small Business Loans Program.

contingently liable for a maximum of \$1.4 billion.

29.18 The Program is generally used to finance new and early-stage (one to three years old) enterprises. As shown in Exhibit 29.3, 66 percent of new loans issued in 1996–97, in terms of value, were for newly created businesses (47 percent) and enterprises that had been in existence for less than three years (19 percent).

29.19 The chartered banks issued \$1.5 billion or 78 percent of the loans guaranteed during 1996–97 (see Exhibit 29.4). They held \$4.8 billion or 80 percent of the total outstanding loan guarantees at 31 March 1997. Loans outstanding under the Program represented more than 20 percent of commercial bank lending for amounts of less than \$250,000.

29.20 As shown in Exhibit 29.5, the level of claims has also increased significantly since 1993. Between 1 April 1993 and 31 March 1997, Industry Canada paid 8,217 claims amounting to \$274 million and received fees of \$233 million. Of the claims paid in 1996–97, one half related to loans issued in 1994–95 and approximately one third related to 1993–94 loans (see Exhibit 29.6). Nearly 75 percent of the

value of claims paid was for loans made to new businesses.

## The small business sector has been the subject of much recent study

Many studies on the small business sector have been carried out in recent years. At the federal level, the 1994 Department of Finance and Industry Canada joint report "Growing Small Businesses" referred to the growth of small business as essential to job creation in Canada. The report also identified access to capital as a critical issue and noted the importance of a positive business environment to small business growth. It set out the approach that the government intended to take to create this environment primarily by working closely with other economic players and introducing new policies and programs to support small business.

29.22 The October 1994 House of Commons Industry Committee report "Taking Care of Small Business" stated that the Small Business Loans Program should continue to provide support to small businesses. The Committee expressed concerns, however, about the increasing costs of the Program and stated that any changes should consider not only costs but also the significant benefits. It raised the issue of a possible preference

Exhibit 29.3

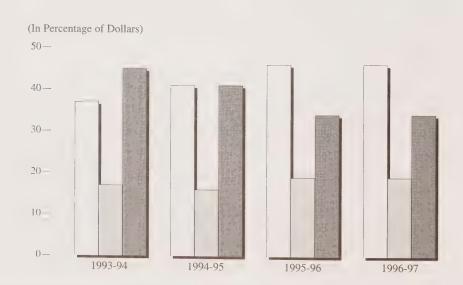
SBLA Loans Issued, by Age of Business

Newly created

1 to 3 years

More than 3 years

**Source:** Industry Canada SBLA Database



given by the Program to banks over other lenders. The Committee also believed that the government guarantee should be used to increase the availability of credit rather than to allow lenders to reduce their risk on loans that they would have made without the guarantee.

29.23 In November 1994, the Small Business Working Committee, set up by the ministers of Finance and Industry and made up primarily of representatives from small business, released a report entitled "Breaking Through Barriers". This report highlighted some significant challenges that small and medium-sized enterprises face. One of these challenges is obtaining suitable financial support to expand. The report stated that without adequate financing, growth of these businesses would be stunted and the future prosperity of Canada could be threatened. The Committee recommended a series of initiatives to provide a sound basis for small business growth and development. Those initiatives included increasing financial institutions' participation in debt financing, together with using the government's leverage to encourage competition among financial institutions to significantly increase their appetite for lending in the small business market.

29.24 Financial institutions have responded to these government reports with new initiatives. All of the major banks and several other financial institutions have introduced new services or products for small and medium-sized businesses in recent years. Many of these products have been the result of joint efforts among the financial institutions, the federal regional development entities and the Business Development Bank of Canada.

29.25 In addition, the Canadian Banking Association has developed quarterly business credit statistics that provide an ongoing view of the small business lending in Canada. It has also developed an alternative dispute

resolution process and a code of conduct for dealing with small businesses. As well, each of the banks has appointed an ombudsman to handle complaints from small businesses. Finally, in 1996, a banking industry ombudsman was appointed to address small business complaints that individual banks were not able to resolve.

#### Focus of our audit

29.26 The objective of our audit was to determine whether Industry Canada has the systems and practices in place to assess whether the Small Business Loans Program is delivered efficiently, in a cost-effective manner and in accordance with the Small Business Loans Act and Regulations. Further details on the audit objective, scope and criteria are found at the end of the chapter in the section About the Audit.

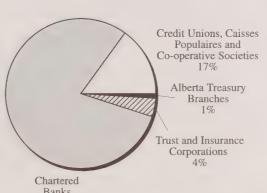
## Observations and Recommendations

## **Objectives of the Program and Evaluation of Results**

Clear statements of expected results are needed

**29.27** The primary objective of the Small Business Loans Program, according to the *Small Business Loans Act (SBLA)*, is

Exhibit 29.4



78%

SBLA Loans Issued by Financial Institutions in 1996-97

Source: Industry Canada SBLA Database

## Industry Canada - Management of the Small Business Loans Program

to increase the availability of loans for establishing, expanding, modernizing and improving small business enterprises.

29.28 Increasing access to financing is a very broad objective. Since legislative program objectives are often stated in general terms, it is important for program managers to ensure that results expected from the Program are clearly defined.

29.29 The eligibility criteria and the conditions of the Program are stipulated in

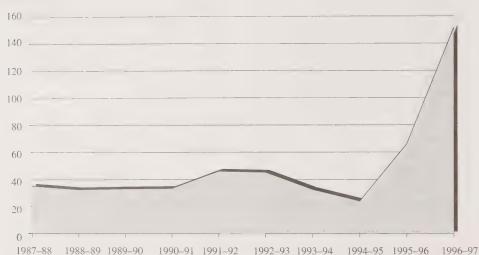
the Small Business Loans Act and Regulations. A major part of the Program is delivered by third parties — private sector financial institutions. It is important to note that, in such circumstances, program managers do not have the same level of discretion in influencing the ongoing delivery of the Program as when they are delivering directly to the client.

29.30 Nevertheless, Industry Canada is responsible for ensuring that the Program is designed in a way that will maximize its

#### Exhibit 29.5

Value of Claims Paid to Lenders, by Fiscal Year

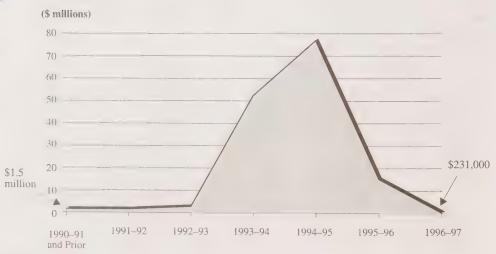




**Source:** Industry Canada *SBLA* Database

## Exhibit 29.6

Value of Claims Paid in 1996–97, by Year the Defaulted Loans Were Issued



**Source:** Industry Canada *SBLA* Database

intended impact, and that expected results are achieved. Clear statements of expected results are prerequisites to sound program design and enable the Department to measure actual results.

- 29.31 Industry Canada has developed indicators to monitor the level and type of activities under the Program. It compiles various operational statistics, such as the number, type and value of loans guaranteed, the number and value of claims paid, and the age of businesses using the Program. Information is also available, for example, on lending by region, type of lenders and size of business.
- 29.32 These data are very useful to provide information on the Program's activity that is, the volume of loans and the characteristics of borrowers and lenders. They do not, however, provide sufficient information on the results being achieved by the Program.
- 29.33 Industry Canada collects and reports information on job creation under the Program. Job creation is one indicator of the degree of success of the Program. There are, however, other important results, some of which might even have a negative impact on job creation. For example, the provision of loans for modernizing small businesses may in fact reduce the level of employment in some cases. However, in such cases other significant benefits may be achieved by increasing the level of productivity and reducing production costs, leading to increased competitiveness.
- 29.34 We believe that SBLA program managers would benefit from defining clear statements of expected results within the framework of the broad legislated Program objectives. For instance, it would be important to clarify expectations and to develop performance indicators regarding the objectives of establishing, expanding, modernizing and improving small businesses. Such expectations could

address, for example, level of sales, profitability, productivity, competitiveness, level of exports, product development, net employment impact and overall business success.

- 29.35 The 1994 report entitled "Taking Care of Small Business" stated that the Program should be reviewed with respect to its costs and benefits. Several studies of the Program have been done over the last 10 years. None of these studies or reviews contained a complete cost/benefit analysis of the Program, and none can be considered a complete program evaluation.
- 29.36 Eligibility requirements and conditions of a program such as the Small Business Loans Program will, by their nature, affect the achievement of specific results. For example, by setting the types of assets to be financed, the loss-sharing ratio and the fee structure, the Program will have a significant impact on the potential users and the extent to which objectives will be achieved. Clear statements of expected results would help program managers establish a clear direction for the Program and ensure that its eligibility criteria and conditions maximize its impact while meeting the evolving needs of small businesses.

#### 29.37 Industry Canada should:

- define clear statements of expected results for the Small Business Loans Program; and
- obtain relevant information on the results achieved by the Program.

Department's response: Since 1961, the Small Business Loans Act (SBLA) has had a clearly expressed objective of increasing the availability of loans for financing small business. As noted by the Auditor General, Industry Canada has been conscious of the need for ongoing monitoring of program performance and has commissioned extensive studies to effectively manage the Small Business Loans Program. Industry Canada is also

There is an opportunity to better define what the Small Business Loans Program is meant to achieve.

It is important to define the expected level of incrementality of *SBLA* loans.

The dual objectives of increasing the availability of loans at reasonable rates while recovering all costs need careful analysis.

updating the program evaluation framework concurrently with the proposed review of the SBLA, and intends to conduct this evaluation at an appropriate point.

There is a need to ensure that Program design is optimal

Clear statements of expected 29.38 results, and information about actual performance are crucial when decisions are made about changes to a program. We noted that some changes have been made to the Small Business Loans Program over the years; however, the extent to which evaluations of previous results have had a significant influence on those changes is not clear. Without precise expectations and information on actual results achieved, there is a risk that program design decisions will not be made on a timely basis or will be unduly influenced by considerations other than those related to the fundamental reasons for the Program's existence.

29.39 There has been much discussion in recent years about the level of incrementality achieved by the Program — that is, the proportion of loans that would not have been made in its absence. Incrementality is central to the purpose of this Program.

29.40 Over the past five years, studies have been done on behalf of Industry Canada on the level of incrementality of SBLA loans. A 1994 study indicated that between 30 and 40 percent of SBLA loans were made to firms that would have received financing from lenders anyway. The latest study, in 1996, indicated that approximately 54 percent of the loans to small businesses, particularly to newly created enterprises, could be deemed as incremental. Given the objective of the Program and the impact of incrementality on its design, we believe it is important for Industry Canada to define the expected level of incrementality of SBLA loans.

29.41 As discussed in paragraphs 29.48 to 29.50 of this chapter, Industry Canada has placed considerable emphasis in the last two years on moving toward full cost recovery for the Program. We consider that the dual objectives of increasing the availability of loans at reasonable rates while recovering all costs need careful analysis.

29.42 We expect that, in future assessments of the Program, the Department would study thoroughly the extent to which these two objectives are simultaneously achievable.

The strategic direction of the Small Business Loans Program has not changed much in the last 36 years. At the time of the original legislation in 1961, the Canadian economy was based much more on manufacturing. The Program then dealt with the issue of the lack of term financing for equipment and leasehold improvements. Although the Canadian economy has evolved significantly since that time, the legislation governing the Program has remained essentially unchanged with respect to the types of assets eligible for financing. The service sector and the knowledge and information sector form a much greater part of the economy today, with the latter sector having a high net employment growth. However, the Program is still directed toward the financing of capital assets (land, premises and equipment).

29.44 In recent years, financial institutions have introduced new services and new products for small businesses. In an increasingly competitive financial market environment, market forces could lead to a better response to the financing needs of small businesses. The need for the Program to meet any financing gaps in the market for small businesses may therefore change significantly.

29.45 New lending under the Program will end on 31 March 1998 unless the government decides to renew it. As part of that decision, it will be important to take into account the needs of a changing

Canadian economy and business environment. The challenge for program managers is to clearly state what this Program is meant to achieve in supplementing services already or potentially available from private sector lenders, and to design a program with eligibility requirements and conditions that will maximize its impact in closing identified gaps in the market.

29.46 Industry Canada should ensure that the *Small Business Loans Act* eligibility requirements and conditions lead to the achievement of the results expected from the Program.

Department's response: The Program's eligibility requirements and conditions will be reviewed in depth as part of the proposed review of the Small Business Loans Act.

## **Objective of Full Cost Recovery**

29,47 The Small Business Loans Program has made net cash payments of \$339 million between its inception in 1961 and 31 March 1993. Industry Canada has reported a combined surplus of \$72 million, on a cash basis, for fiscal years 1993-94 and 1994-95. However, in its 1995-96 annual report, the Department recognized the likelihood of a considerable increase in claims for losses in the next four years. The Department does not expect these increased claims to be fully offset by revenues but has provided no estimate of the shortfall. Our estimate is that the Program will incur a net loss of \$210 million associated with loans issued between 1 April 1993 and 31 March 1995. That estimate was determined by deducting the fee revenues (\$139 million) from the government's share of the claims paid (\$182 million) and projected claims (\$167 million) on the loans issued during that period. The net loss is funded by the government.

## The Program is moving toward full cost recovery

29.48 Industry Canada introduced a policy of full cost recovery for loans made after 1 April 1995. At the same time, the Department's loss-sharing ratio was reduced from 90 percent to 85 percent. Another major change included the introduction of a 1.25 percent annual administration fee, based on the average amount of loans outstanding. According to departmental projections, this should result in full cost recovery over a 10-year period.

29.49 We noted, however, that since 1994–95 the guarantee portfolio contains an increasing proportion of higher-risk loans. For example, we noted an increase in loans to newly created enterprises. In 1996–97, 75 percent of claims against the Program guarantees were for loans that had been issued to start-up companies.

29.50 An internal study conducted for the Department at the beginning of 1997 also indicates a significant increase in the risk of the Small Business Loans Act portfolio during the last two years. The study states that higher default rates are being experienced in 1997 and these defaults are generally occurring earlier in the life of the loans. We believe that program managers need to factor into their projections of future default rates the increased level of risk in the portfolio and the impact of a possible eventual downturn in the business cycle. We consider that under the present fee structure and loss-sharing ratio, it is uncertain whether full cost recovery will be achieved.

29.51 The Department should carefully monitor any developments in the performance of its guarantee portfolio that would prevent it from achieving its financial objective of full cost recovery.

**Department's response:** Industry Canada has been carefully monitoring, through data collection, its move toward cost

Under the present fee structure and loss-sharing ratio, it is uncertain whether full cost recovery will be achieved. recovery for all loans made since I April 1995. An enhanced statistical model to monitor cost recovery is being designed for implementation in 1998–99.

## Systems and practices to forecast future performance of the Program need to be strengthened

29.52 We expected that Industry
Canada would have the capacity and
resources and would have developed
systems and practices to collect and
analyze, on a timely basis, the requisite
information to forecast the performance of
the Program. This is required in order to
monitor the risk exposure of the loan
guarantee portfolio and to support the
financial objective of full cost recovery.

29.53 In recent years, Industry Canada has carried out a number of studies on the performance of its loan guarantee portfolio. The Department has used the information from these studies in assessing loan performance and setting fees. The studies have also taken into consideration the overall economic trends and changes in the guarantee portfolio.

29.54 We believe, however, that more needs to be done to forecast default levels. For example, the Department needs to carry out regular analysis of its guarantee portfolio, including loans by industry, region, age of business, lender and type of asset. Overall economic trends will need to be factored into such analysis.

29.55 In 1994, Industry Canada initiated a project to develop a model to forecast the financial performance of the Program. This model is being revised to include program parameters such as type and size of business, as well as economic indicators. It will be important to periodically obtain information from lenders on loan impairment rates to validate results obtained from the model. As well, it will be important to obtain the resources required to analyze the

information necessary for ongoing monitoring.

29.56 Industry Canada should pursue its efforts to develop systems and practices to forecast the future performance of the Program.

Department's response: Further to our response to paragraph 29.51, an enhanced forecasting model and related systems to monitor cost recovery are being designed for implementation in 1998–99.

#### **Delivery of the Program**

29.57 Good credit risk management by lenders is critical to maintaining the quality of the guarantee portfolio. Credit risk is the risk of loss arising from borrowers who fail to repay their loans. The Program has been structured so that the credit risk is managed by the lending institutions. The expectations are that they will ensure that loans comply with the eligibility requirements and conditions of the Program, and that they will make lending decisions with the same degree of due care and diligence as they do with their other loans that are not guaranteed under the Program. We expected that Industry Canada would have the mechanisms in place to obtain assurance that lenders are meeting those expectations.

## Claims from lenders need to be more carefully assessed

assurance on the quality of credit risk management procedures by focussing on claims submitted for payment. The Department reviews every claim that lenders submit to determine if the loan has been issued in accordance with the *Small Business Loans Act* and Regulations. This review is intended to determine whether the loan meets Program eligibility criteria such as the size of the business, its business activities, the type of asset financed, and the terms of the loan. The review also includes an assessment of the

Industry Canada does not assess whether the lender has exercised due care when making a loan. information related to the realization of collateral or security.

29.59 Up to 31 March 1997, the Department indicated that it had received claims of \$299 million relating to loans issued after 31 March 1993. The payments made on these claims amounted to \$206 million, or 69 percent of claims received. The balance of claims were either reduced or rejected.

29.60 The exercise of due care when making loans is a fundamental requirement outlined in the "SBLA Guidelines for Lenders". We noted. however, that as part of its review, Industry Canada does not assess whether the lender has exercised due care when making a loan. This may result in the Department making payments for claims related to loans where the lender has not exercised the expected due care. The illustrative case studies on pages 18 and 19 provide examples of a loan for which a claim has been made (Case Study 1) and a loan for which all debt obligations have been met (Case Study 2).

29.61 We reviewed a statistical sample of lenders' loan files both for outstanding loans and for loans that had defaulted and had subsequently been the subject of a claim to Industry Canada. Our objective was to assess the quality of the review process that lenders follow when approving *SBLA* loans.

29.62 We noted that lending institutions had similar policies for both *SBLA* and non-Program loans. We focussed our review on the key aspects of a rigorous loan analysis — that is, the assessment of management capability, market potential and financial viability. We looked for evidence of appropriate analysis in the files, such as a business plan, an analysis of market potential, information on the competition, financial statements and projections and an analysis of the borrower's ability to repay the loan.

29.63 We found that, in some instances, the loan files did not contain the information necessary to perform a thorough credit risk analysis. These files were mainly lacking information such as a business plan, a market analysis and financial projections. We consider that Industry Canada needs to encourage lenders to assess their SBLA loans more carefully. It also needs to increase its level of assurance that lenders have applied the expected due care in reviewing loans submitted for claim payments.

29.64 Industry Canada does not request access to the complete loan file when it receives a claim. Therefore, the Department does not have the information to identify some cases of non-compliance with the Small Business Loans Act. More specifically, we found in our review of loan files a number of cases where, contrary to the Act, the lender had charged administration fees. Such non-compliance makes a loan ineligible under the Program. We also found a number of cases where lenders had charged fees for a financing package that included SBLA and non-Program loans. We could not determine if a portion of the fee was applicable to the SBLA loan. However, we noted some cases involving high administration fees even though the non-Program portion of the financing package was not significant.

29.65 Finally, we noted significant variations among the rates of claims submitted by different lenders. Various explanations exist for these variations, for example, differences in the rate of incremental loans. However, a higher rate of claims from a particular lender could also be an early warning that the lender is not exercising due care in assessing loans under the Program. Another indicator is the higher proportion of impaired loans within a lender's SBLA portfolio. Consequently, such indicators could be considered by Industry Canada in formulating an effective strategy to ensure Some loan files did not contain the information necessary to perform a thorough credit risk analysis.

We found a number of cases where, contrary to the *Small Business Loans Act*, the lender had charged administration fees.

#### **Illustrative Case Studies**

To understand better the intent of the Small Business Loans Program and the contribution that it makes to small business financing, we present two case studies. Case Study 1, a small business, has been unable to pay off its loan and a claim has been made under the Program. Case Study 2, another small business, has received a loan guaranteed under the Program and, to date, has been successful.

## Case Study 1 — An Example of a Loan for Which a Claim Has Been Made

Loan			\$250,000
Industry			food services
Employees			12
Forecast annual sales	. 2	3	\$700,000
Age			new
Assets			\$330,000
Equity			\$80,000
Purpose of loan			to buy furniture, equipment and make leasehold improvements to start a new restaurant
Alternative sources of financing			significant personal net worth of the owners

In early 1995, the owners opened a restaurant in the downtown area of a major Canadian city. They leased space, making necessary improvements to the leasehold, and acquired equipment and furnishings. The restaurant was a franchise. The market for the product and service was unknown. Neither of the owners had any previous experience in the food services industry. A cash forecast was developed, and a franchise document was provided, but no business plan was prepared. The assets financed were for the most part leasehold improvements. Loan financing came from a \$250,000 loan through the Small Business Loans Program. Sales did not meet expectations and within a year the business failed. Only \$35,000 was realized on the collateral and security for the loan. Although the personal net worth of the owners was significant, the total loss they incurred was \$105,000, of which \$80,000 was their original equity contribution. This is significantly less than the \$188,000 loss experienced by the government.

Conclusion: This was a start-up business. The loan had not been subjected to a rigorous credit risk analysis and thorough market research; nor was there a business plan.

## Case Study 2 — An Example of a Loan for Which All Debt Obligations Have Been Met

Loan	\$128,000
Industry	business services
Employees	3 and the second of the second
Forecast annual sales	\$180,000
Age	new
Assets	\$170,000
Equity was a single selection of the latest and the	\$35,000
Purpose of loan and the Control of t	to buy the equipment needed to start a new business
Alternative sources of financing	equity contributed by venture capitalist; no other financing available

In early 1996, the owners established a records management business that used automated scanning technology to convert paper records to electronic form. The owners acquired the necessary equipment with capital invested by a venture capitalist and funds loaned through the Small Business Loans Program. The market for the product was assessed in detail and a business plan was prepared. A cash forecast was developed. The owners prepared themselves for the new enterprise through training in using the new equipment and software and in starting a business. The lenders determined that there was a market value for the assets in the event that they would have to be sold, and obtained a collateral mortgage on the equipment and a 25 percent personal guarantee from the owners. At the time of our review, the business was succeeding and had met all its debt obligations.

Conclusion: This was a loan that had been subjected to a rigorous credit risk analysis. The borrower had also developed a sound business plan and conducted thorough market research.

There are no provisions in the *Small Business Loans Act* to prevent a group of related entities from gaining access to loans beyond the maximum amount allowed.

that lenders are making SBLA loans with due care.

29.66 Industry Canada should ensure that lenders have exercised due care in making loans and have complied with the *Small Business Loans Act* and Regulations.

Department's response: Claims are paid on loans made in accordance with the requirements of the Small Business Loans Act (SBLA) and Regulations. Industry Canada will continue to explore ways and means of amending the legislation and regulations to reinforce the exercise of due care, and provide clearer guidance to lenders under the SBLA.

## Related borrowers exceeded maximum loan limit

29.67 The Small Business Loans Act limits the amount of lending to a borrower to a maximum of \$250,000. In our sample of loan files, we noted some cases in which a number of individual corporations with substantially common ownership had collectively obtained more than \$250,000 in loans to operate the same business. In one particular case, a group of 23 corporations obtained more than

\$4 million in *SBLA* financing. Exhibit 29.7 outlines three cases that came to our attention in which the maximum limit was exceeded.

29.68 Such situations increase the credit risk exposure and, possibly, future losses on the loan guarantee portfolio. Although Industry Canada had indicated, in correspondence with lending institutions, that such loans would not be covered after July 1996, the cases that came to our attention had been registered after that time. Again, without access to the complete loan file for claim review, it could be difficult for Industry Canada to detect these cases.

29.69 Although the *Small Business*Loans Act specifically defines who may borrow under the Program, there are no provisions designed to prevent a group of entities with substantially common ownership from gaining multiple access to loans under the Program. Such rules do exist under the Income Tax Act, which has provisions designed to limit access to the low corporate rate of tax for small businesses and to prevent abuse by the creation of a number of related corporations. Clarification of this issue would help to ensure that the Program

#### Exhibit 29.7

Examples of Cases in Which Maximum Loan Limit Was Exceeded

- Case 1 A public corporation sold the assets of one of its subsidiaries to its senior management. The sales revenue for the new corporation was projected to be \$4 million for the first year. The new owners needed financing of \$950,000 to buy the assets of the company. They created three related companies in order to obtain most of the financing through three SBLA loans of \$250,000 each. One company purchased the leasehold improvements and furniture and the other two purchased the equipment. These loans were approved in September 1996 and registered in November 1996. The lender also charged \$2,000 for negotiating this financing package.
- Case 2 A group of 23 related corporations obtained more than \$4 million of SBLA loans. The group had an equity of \$7 million as of August 1996. The SBLA loans were used to purchase new equipment and to make leasehold improvements. The loan examined in our sample was approved in July 1996 and registered in September 1996. The lender also charged a monthly administrative fee on this loan.
- Case 3 A group of retail stores, with loans totalling \$7.8 million from the same lender, used two corporations in order to obtain approximately \$500,000 in *SBLA* loans. The group had an equity of \$2.5 million. The *SBLA* loans were used mainly for leasehold improvements. The loan examined in our sample was approved and registered in September 1996.

meets its intent of providing assistance to small businesses within an acceptable level of risk exposure to the government.

29.70 Industry Canada should assess the need to limit access to loans by related entities to the maximum amount allowed and, if the need exists, seek amendment to the *Small Business Loans Act*.

Department's response: A Notice to Lenders was issued in May 1996 to address this specific issue, and further changes will be introduced at the time of the proposed review of the Small Business Loans Act.

#### Interest paid to lenders can be reduced

29.71 The Small Business Loans Act and Regulations require a lender to file a claim on a defaulted loan after having completed all collection procedures. It allows for a period of three years for the lender to file a claim. During the first year, the Department pays the lender a rate of interest equal to the rate at which the loan was issued, usually prime plus three percent. For the second and third years, the rate of interest paid is reduced by half.

29.72 We noted that, on average, lenders submit claims 260 days after the default of a loan. In 1996–97, the Department took an average of 76 days to process claims submitted by lenders. This situation is due in part to the significantly higher volume of claims submitted in the last two years as well as to the number of errors found in the claims.

29.73 The re-engineering of business and management practices and the hiring of additional auditors allowed the Department to significantly increase its claim-processing capability in the last 18 months. The Department advised us that the average time to process a claim is now approximately 30 days.

29.74 The Department was unable to provide us with the amount of interest paid to lenders in 1996–97. We estimate the amount to be at least \$10 million. Industry Canada informed us, however, that since February 1997 the new *SBLA* system captures capital and interest payments separately. The Department indicated that for the period 1 April to 30 September 1997, \$15.6 million of interest was paid to lenders on claims of \$119.3 million.

29.75 We believe that the Department could reduce the interest cost it incurs before and after a claim is received. For instance, it could make provisional payments to lenders after loans have defaulted and settle the balance after a full audit of the claims.

29.76 Industry Canada should take appropriate steps to reduce the interest it is paying on claims submitted by lending institutions.

Department's response: Industry Canada will routinely revisit the conditions tied to the liability of the Minister under the Small Business Loans Act as part of the proposed review of the Act. As noted in the Report, the average processing time for claims has been significantly reduced, and Industry Canada will continue to explore ways of controlling overall costs of the Program.

### **Accountability to Parliament**

29.77 Part III of the Estimates and the Minister's annual report on the Small Business Loans Program have been, to date, the primary instruments used to report to Parliament. To assess the quality of the information provided, we examined Part III of the Estimates for 1995–96 and 1996–97, and the annual reports for the years ended 31 March 1995 and 31 March 1996. The annual report for the year ended 31 March 1997 had not been tabled in Parliament at the completion of our audit. For the same reason, we did not examine the performance report that will be tabled

by Industry Canada under the new Expenditure Management System.

## Better information on performance is needed

29.78 In Part III of the Estimates, Industry Canada provides information on the number of small businesses using the Program, the number and value of loans issued, the number of loans to be issued, the anticipated total amount of guarantees and the projected job creation. The annual report provides information on access to funds, creation of jobs, and the costs, revenues and outputs of the Program.

Parliamentarians do not have the information necessary to assess whether the Small Business Loans Program is managed efficiently and is achieving its objectives.

29.79 These two documents provide information useful for understanding the context in which the Program operates. However, the activity measurements presented are generally operational statistics, such as the number and value of loans guaranteed, claims paid and loans by financial institutions and by province. We believe that such descriptive information does not enable parliamentarians to assess the extent to which the Program is managed efficiently and is achieving its objectives.

29.80 Information on the Program's results would include the extent to which the Department has achieved its financial objective of full cost recovery and its program objective of increasing the availability of financing to small business. Information on the achievement of the financial objective would need to be on an accrual basis and include revenues, administrative and claims expenditures, and a provision for loan losses. In paragraph 29.34, we stress the need to define clear expected results for the Program. This would enhance the capability to provide better information to parliamentarians on performance.

29.81 Industry Canada should ensure that parliamentarians are provided with the information necessary to assess the extent to which the Program is managed

## efficiently and is achieving its objectives.

**Department's response:** As noted by the Auditor General, Industry Canada implemented a new information system in 1997 that will allow the Department to supplement, in its 1997-98 report, the information already being provided annually to Parliament. Such information includes at this time lending activity by province, types of lenders and size of business enterprise, as well as claim activity levels, management of program costs and revenues, and the Minister's liability on outstanding loans. In the 1997–98 report to Parliament, Industry Canada will also provide information by industry sector, and report on the efficiency with which the Department has managed program operations in the attainment of program and financial objectives.

## Information on jobs created does not reflect actual results

29.82 In its annual report, Industry Canada reports on the number of jobs that borrowers have created under the Program. The 1995–96 annual report, for example, indicated that 81,600 jobs were created during the period, representing 37 jobs per \$1 million of loans guaranteed. Similar numbers were reported in the 1994–95 annual report. We noted that Industry Canada obtains this information through a survey of the loan guarantee registration forms that are prepared by lending institutions and that contain projections of job creation.

29.83 In general, we would have expected more rigor in evaluating the job creation impact of the Program for purposes of reporting to Parliament. For example, the information collected at the time of registration does not take into account "displacement effects" (some loans may result in the displacement of workers in other businesses), which would reduce the net number of jobs created. Some loans actually result in lower direct

employment levels — for example, when loans are used to buy labour-saving equipment. The fact that a certain percentage of these loans would have been made without the Program (non-incremental loans) also needs to be considered when computing the number of jobs created. Information on the nature of jobs created could also be useful — for example, whether these jobs are temporary, long-term, low- or high-skill, low-paying or high-paying.

29.84 Industry Canada recently completed a study of the economic effects of the Program. This study suggests much lower employment growth figures than those shown in the last two annual reports. The study also indicates that the Program resulted in about seven jobs per \$1 million of loans guaranteed.

29.85 Industry Canada should report information on job creation that reflects actual results attributable to the Program.

Department's response: Employment growth estimates are provided by individual enterprises at the time of loan application. In addition, Industry Canada regularly commissions research studies into the actual employment impact of the Small Business Loans Act. Industry Canada will continue to commission studies to validate the net impact of the Program, including those of job creation and growth as part of the ongoing program evaluation process.

#### **Conclusion**

29.86 The Small Business Loans Program has been financing capital assets since its inception in 1961. The government incurred significant costs under the Program and a decision was made to move toward full cost recovery for loans made after 1 April 1995.

29.87 New lending under the Program will end on 31 March 1998 unless the government decides to renew it. This presents an opportunity to review the Program's contribution to filling current financing gaps and stimulating economic growth and creating jobs. The review would also enable Industry Canada to assess whether the Program meets the needs of small business in a rapidly changing economy.

**29.88** We offer in this chapter various suggestions that we believe will be helpful in that review and will contribute to improving the delivery of the Program.

We expected more rigor in evaluating the job creation impact of the Small Business Loans Program.



## **About the Audit**

### **Objective**

The objective of our audit was to determine whether Industry Canada has the systems and practices in place to assess whether the Small Business Loans Program is delivered efficiently, in a cost-effective manner and in accordance with the *Small Business Loans Act* and Regulations.

#### Scope

The audit covered the activities of the Small Business Loans Program, including the related activities of the Small Business Loans Administration Directorate, the Entrepreneurship and Small Business Office in Industry Canada, the regional development entities and lenders. We reviewed the operations of the Program for the period 1 April 1993 to 31 March 1997.

#### Criteria

The broad audit criteria for this audit were:

- objectives of the Small Business Loans Program should be clearly articulated and the results should be measured, compared and reported;
- the Program should have appropriate internal and management controls to ensure that all revenues are collected and recoveries are maximized in conformity with good business practice;
- the Program should be administered efficiently and cost effectively; and
- Parliament should be provided with relevant, reliable and timely information on the performance of the Program.

## **Approach**

We interviewed officials of Industry Canada and of federal regional development entities as well as some Small Business Loans Program lenders. We also interviewed a number of loan officers and examined a statistical sample of lenders' files of registered loans and claims. In addition, we examined relevant documents including departmental and other studies, parliamentary debates, Part IIIs of Estimates and Small Business Loans Program annual reports. We also held a stakeholders' meeting that included representatives of lenders and borrowers, as well as experts in the subject matter, in order to understand their needs for access to financing.

#### **Audit Team**

Christian Asselin Louise Bertrand Luc Demers Bryan De Pape Denis Robert

For information please contact Harry A. Ruthnum, the responsible auditor.

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Report of the **Auditor General** of Canada to the House of Commons

Chapter 30 Office of the Superintendent of Financial Institutions - Insurance and Pensions

December 1997



Report of the Auditor General of Canada to the House of Commons

Chapter 30
Office of the Superintendent of Financial Institutions – Insurance and Pensions

December 1997

This December 1997 Report comprises 16 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, October and December 1997 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.



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# Chapter 30

Office of the Superintendent of Financial Institutions — Insurance and Pensions

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Assistant Auditor General: Ron Thompson Responsible Auditor: Crystal Pace

# Office of the Superintendent of Financial Institutions — Insurance and Pensions

# **Main Points**

- 30.1 Since 1987, when the Office of the Superintendent of Financial Institutions (OSFI) was established, the financial services industry has become much more integrated. The legislative framework has developed from a highly prescriptive system to one relying heavily on good corporate governance to ensure that depositors, policyholders and pension plan members are protected, without unduly restricting the competitive ability of Canadian financial institutions. Legislators have recognized that although regulation and supervision can reduce the risk that financial institutions will fail, some may fail nonetheless. OSFI has made significant progress in developing regulatory tools to meet its objectives, in response to the changing nature of the industry and the legislative framework. Although OSFI meets the needs of today's environment, it nevertheless needs to address important gaps that could affect its ability to meet its objectives in the future.
- 30.2 A key to success for OSFI is having the right people with the right competencies and using them effectively. OSFI has the basic human resource management systems in place and operating, and is moving forward on a variety of fronts. However, at this point it does not have some important information that it needs to estimate the degree to which activities planned or under way will help it achieve its objectives. It needs to have a more strategic approach to human resource management and a more rigorous analysis of issues to ensure that current and planned activities will help it meet its goals and objectives.
- 30.3 Overall, we found that OSFI is highly regarded by the insurance industry and by provincial and foreign regulators. It has developed some key aspects of its risk assessment and risk management framework standards for sound business and financial practices, and guides to intervention. However, they are not yet complete. We identified gaps in the implementation of the framework that could prevent OSFI from meeting its objectives in the future. For example, it needs to apply its risk ratings more rigorously; focus its life insurance examinations on key risks; and improve the integration of its analysts, examiners and actuaries. In addition, communication and co-ordination with regulated entities and other regulators need to be improved.
- 30.4 The supervision of pension plans at the federal level is in a state of transition. OSFI has recognized the need for a new regulatory framework that includes a new mandate focussed on protecting plan members, greater powers to intervene when plans are in difficulty, and formalized procedures for risk assessment. OSFI plans to establish a *Guide to Intervention* and *Standards for Sound Governance and Financial Practices* for pension plans.



# Introduction

**Evolution of the Office of the Superintendent of Financial Institutions** 

30.5 Putting it all under one roof. OSFI was first established in 1987 by the amalgamation of the Department of Insurance and the Office of the Inspector General of Banks. This put the federal supervision of banking, insurance and pensions under one authority. However, OSFI was still organized internally along business sector lines, with little commonality among them in the regulatory framework or the systems for assessing risk. There were still clear distinctions among the financial industry's "four pillars" — banks, trust companies. insurance companies and securities firms.

30.6 Changes to investment and ownership rules. In 1992, important legislative changes were introduced to reflect the changing nature of the financial services industry. Restrictive investment criteria were replaced by "prudent person" criteria. Restrictions on cross-ownership among banks, trusts and securities firms were eased. These changes made it imperative that the financial regulatory framework provide a "level playing field" for the three pillars regulated by OSFI banks, trust companies and insurance companies. The change from restrictive investment criteria meant that OSFI no longer needed to verify that investments met the detailed requirements of the legislation. Instead, it began to change its focus from compliance to issues of solvency and good corporate governance to ensure that regulated entities were managed prudently.

30.7 Introduction of "Standards" helped implement the new legislative framework. In 1993, Canada Deposit Insurance Corporation (CDIC) adopted as regulations the "Standards for Sound Business and Financial Practices" for deposit-taking institutions that are

members of CDIC. These Standards, while further defining good corporate governance, helped OSFI and CDIC use sections of the legislation that permitted sanctions for poor practices. This allowed them to respond earlier when financial institutions deteriorated. Similar standards for life insurance companies were developed jointly by the industry and OSFI and were adopted in January 1997. Once those have been implemented, OSFI and the Insurance Bureau of Canada (IBC) will develop standards for property and casualty companies. OSFI is developing standards for pension plans as well.

30.8 Guides to intervention helped to develop the framework. In February 1995, the Guide to Intervention for Federal Deposit-taking Institutions and the Supervisory Guide Applicable to Federally Regulated Insurance Companies were introduced to promote awareness and enhance the transparency of the system of intervention in federally regulated financial institutions. The guides outlined the steps that OSFI could be expected to take if the financial condition of an institution deteriorated. They outlined the criteria for determining the degree of intervention required, ranging from "stage 0", for institutions of no concern, to "stage 4" for institutions on the verge of failure. The disclosure of this process and of the actions that are considered at each of the stages of intervention has improved the understanding of OSFI's supervisory role. The 1995 guide for deposit-taking institutions also covered CDIC's role in the intervention process. In January 1997. the actions of CompCorp, the compensation fund for policyholders of failed life insurance companies, were incorporated into the guide for life insurance companies. OSFI is developing a similar guide for pension plans.

**30.9 OSFI reorganized to help meet the needs.** In August 1995, OSFI reorganized in response to the increasing breakdown in the distinctions among the four financial institution pillars and to the

OSFI has changed its focus from compliance to issues of solvency and good corporate governance to ensure that regulated entities are prudently managed.

1996 legislation provided a clear mandate for OSFI's regulation of deposit-taking institutions and insurance companies.

creation of more financial conglomerates. Its supervisory work for all federally regulated financial institutions and pension plans was centralized in a new Operations Sector. Another objective of the reorganization was to establish a more consistent approach to policy development for financial institutions, regardless of type. The policy-making divisions of each OSFI financial services industry group were merged to create a new Policy Sector, which assumed responsibility for all policy development in OSFI. The new structure improved consistency in decision making with respect to financial institutions and enhanced the supervision of financial services conglomerates.

New legislative mandate helped. The basis for efficient and effective operations is a good accountability arrangement. This is particularly important for OSFI because its operations are funded primarily by the entities it regulates. In 1996, legislation was passed that provided a clear mandate for OSFI's regulation of deposit-taking institutions and insurance companies. The legislation set out a number of objectives specifying how OSFI should achieve its purpose of contributing to public confidence in the Canadian financial system. The mandate states that in carrying out its objectives, OSFI "shall strive to protect the rights and interests of depositors, policyholders and creditors having due regard to the need for financial institutions to compete effectively and take reasonable risks."

30.11 OSFI proposed a similar mandate for pension plans in its July 1996 White Paper. In addition to clearer authority, the White Paper proposed stronger regulatory and supervisory powers for OSFI and resulted in the tabling of Bill C-85, which died on the Order Paper when an election was called in April 1997.

**30.12** Strategic objectives established. OSFI established a new mission statement and, in 1996, strategic objectives, as first steps in implementing its new mandate

(Exhibit 30.1). It also reviewed its legislated responsibilities, and began a process to transfer to other organizations some of the responsibilities not directly related to its mandate. (For more information see OSFI's Annual Report and Part III Estimates, on the Internet site http://www.osfi-bsif.gc.ca.)

Good progress in developing performance measures. OSFI is now in the process of developing key performance measures to compare results achieved with expected results for each of its strategic objectives. These measures will include indicators of change in industry-wide risk, the relative cost to industry of OSFI's regulatory requirements, and service standards. OSFI told us it intends to use the resulting information internally to manage its performance, and plans to publish some of the indicators in its 1998-99 Annual Report. In our view, OSFI is at the forefront in developing performance measures for a regulatory regime.

30.14 Linking goals to activities is a challenge. Completing its accountability framework will be the next challenge for OSFI. It needs to complete recent initiatives aimed at describing more clearly how its activities contribute to its strategic objectives and at what cost, and needs to use this information to allocate resources more efficiently and effectively (Exhibits 30.2 and 30.3).

Changing environment will mean new ways of regulating

30.15 Technology impacts are profound. The impacts of technology present a large future risk for all regulators. OSFI has begun to study the challenges it faces as many unregulated entities begin to offer services traditionally offered only by regulated entities, and as regulated entities adopt new ways of doing business. OSFI will have to deal with outsourcing of operations, new forms of business such as insurance sold over the Internet and,

potentially, the entry of insurance companies into the Canadian payments system for cheques and other financial instruments.

30.16 New complexities add risk. It is increasingly difficult to separate the business lines of insurance, investment and banking. To illustrate, the life insurance industry reported that insurers made payments of more than \$30 billion to their Canadian customers last year, but less than 10 percent of this was in death benefits. About 60 percent of the balance was from wealth management and wealth accumulation products, with the other 40 percent split between life protection and health and disability products.

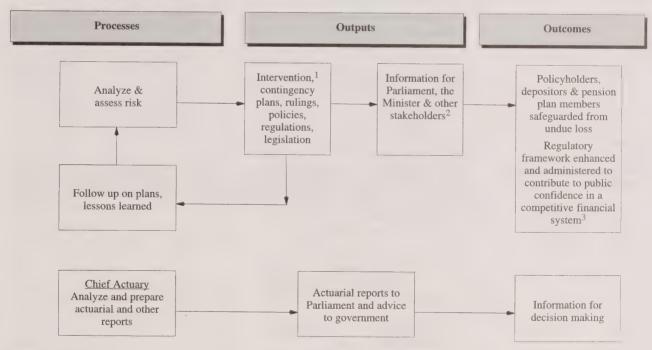
**30.17** New products and increased competition were cited by industry people

we interviewed as areas of high risk. In the past, products were fairly constant from one year to the next. Now there are new products on the market almost every day. The new products may compete with products in other sectors — annuities may substitute for guaranteed investment certificates, for example. The entities developing the products may not price them appropriately. Or they may risk promising too much to the consumer. resulting in huge liabilities from lawsuits like those seen recently over "vanishing premiums". While industry rating agencies found that ratings of Canadian life and health insurers are high by international standards, they warned in May 1997 that a tough competitive environment may lead to downgrades in the ratings.

Of more than \$30 billion paid by insurers to their Canadian customers last year, less than 10 percent was in death benefits.

Exhibit 30.1

**OSFI Logic Model** 



Notes:

<sup>&</sup>lt;sup>1</sup> Intervention includes all of the possible remedies available to OSFI.

<sup>&</sup>lt;sup>2</sup> There are many stakeholders with information needs.

<sup>&</sup>lt;sup>3</sup> Derived from OSFI's legislative mandate and strategic objectives

30.18 Restrictions on free trade continue to decrease. In July 1995, Canada signed an interim deal on trade in financial services under the General Agreement on Trade Services (GATS) of the World Trade Organization (WTO). Under this agreement, Canada retained certain limitations that could be changed when the interim agreement expires at the end of 1997. Increased trade in financial services provides an opportunity to Canadian companies to sell more products abroad. It also creates risk through increased competition and the difficulty of regulating the Canadian operations of companies based outside Canada.

Regulating large, complex, international conglomerates or large, complex pension plans will pose challenges to regulators in the future.

30.19 Need for increased co-operation and speed. These changes all point to the need for increased co-operation with other regulators, both provincial and foreign, and the need for increased ability to respond quickly to new developments.

**30.20** The former chairman of the U.S. Federal Deposit Insurance Corporation (FDIC), in a January 1997 speech, recognized the need to be proactive and to plan well. "In containing the most recent

Exhibit 30.2

Historical Comparison of OSFI Costs 1988–1996

	31 March 1988 (\$ millions)	31 March 1996 (\$ millions)
Operations Sector		
Life Insurance Division	2.7	5.4
P&C Insurance Division	2.3	4.1
Pension Plans Division	1.2	2.4
Deposit-taking Institutions Division	5.9	8.0
Subtotal	12.1	19.9
Policy Sector	1.4	5.1
Corporate Services and Superintendent's Office	6.7	11.1
Chief Actuary	_1.6	_2.2
OSFI total	21.8	38.3

Source: OSFI

Exhibit 30.3

Use of OSFI Resources

Full-time equivalents, by division

	31 March 1988	31 March 1996
Operations Sector		
Life Insurance Division	46	63
P&C Insurance Division	37	50
Pension Plans Division	28	29
Deposit-taking Institutions Division	89	86
Subtotal	200	228
Policy Sector	26	59
Corporate Services and		
Superintendent's Office	83	82
Chief Actuary	20	20
OSFI total	329	389

Source: OSFI

banking crisis...two lessons [have been] learned...first...monitor and assess risks in the industry in a way that anticipates future problems...second...a more systematic approach to managing ourselves to assure continued success in the future...planning, organizing, directing and controlling what we do to meet our objectives...All other functions of management rest on planning."

- 30.21 Many regulators, including OSFI, have recognized that one way to improve regulatory response time is to establish incentives that enhance the industry's efficiency, such as linking regulatory charges to the level of service required, increasing public disclosure of entity information, and increasing the transparency of regulatory expectations and requirements.
- 30.22 For example, the U.S. Federal Reserve (the Fed) has streamlined the process for approving new activities, using disclosure as a regulatory tool.

  Well-managed and well-capitalized bank holding companies may now start certain new activities without prior approval. However, they must publish their application in order to allow for community input, and notify the Fed within 10 days. The Fed determines whether the company qualifies as "well managed and well capitalized".
- 30.23 Recognizing the need for better co-operation, in December 1996 OSFI established the position of Special Advisor to the Deputy Superintendent of Policy. The Special Advisor is responsible for developing plans to improve relations with other regulators.
- **30.24** OSFI will need to continue evolving in response to increasingly rapid changes in the industries it regulates.

#### Focus of our audit

30.25 This audit was intended to determine whether the Office of the Superintendent of Financial Institutions

(OSFI), with respect to its insurance and pensions operations:

- has a clear mandate, roles and responsibilities as well as adequate performance measures, internal quality controls and reporting to meet its accountability requirements;
- has adequate and efficient systems, procedures and capabilities to safeguard policyholders and plan members from undue loss:
- contributes to public confidence by anticipating future challenges and adjusting its activities to meet them.
- **30.26** Further details on our objectives, scope and criteria can be found at the end of the chapter, in **About the Audit**.

#### Follow-up of previous audit work

30.27 Our last audit of insurance and pensions regulation was described in our 1986 Report, Chapter 12, on the Department of Insurance. Of the 25 recommendations in that chapter, OSFI has implemented or made significant progress with 22. Outstanding issues related to integration of human resource planning with operational planning, and to better co-ordination and integration of the work of examinations and analysis staff, are discussed later in this chapter.

**30.28** In 1995 we reported on OSFI's regulatory activities with respect to deposit-taking institutions. In accordance with our normal practice, we will conduct a follow-up audit on those recommendations in the future.

# Observations and Recommendations

# **Human Resource Management**

**30.29** OSFI is an organization of fewer than 400 people (Exhibit 30.3) located in five urban centres — Ottawa, Montreal, Toronto, Winnipeg and Vancouver — with

OSFI will need to continue evolving in response to increasingly rapid changes in the industries it regulates.

different operational requirements and different external labour markets. Good human resource management and its integration with strategic business objectives are essential to achieving the organization's mission and strategic objectives. We reviewed OSFI's human resource management as it applies to insurance and pensions operations.

OSFI has identified some key human resource management issues

30.30 Having the right staff is critical to OSFI's success. Several aspects of human resource management are viewed by OSFI as particularly important to the organization. For example, the ability to attract highly qualified staff could be expected to impact on the organization's stated objectives in the areas of "safeguarding from undue loss", "quality" and "public confidence". Retaining valued staff also has implications for these objectives (in terms of developed expertise and continuity) as well as for cost effectiveness. Finally, staff competencies — the capacity of staff to understand the institutions they regulate and to be up-to-date on industry developments — are critical to OSFI's achieving its strategic objectives and becoming a learning organization.

30.31 OSFI's framework for human resource management — the related philosophy, policies and systems, and the accountability and control framework — has been in revision for the past two years to make it more responsive to OSFI's changing needs. For example, clearly stated values and new performance assessment practices have been adopted, a new job evaluation and classification plan is being developed, and an employee survey is being carried out.

30.32 OSFI has identified a number of issues. OSFI has identified certain human resource management issues that need to be addressed. In its view, three

key areas in particular — staff recruitment, retention and learning need significant strengthening.

30.33 OSFI recognizes that its difficulty in obtaining qualified human resources and appropriate skills is related to its human resource management framework and to the effectiveness of systems for staffing, compensation, career management, and professional development. These issues and supporting systems are interrelated — action in one area can impact on another area.

30.34 Will corrective actions under way resolve the issues? A significant number of initiatives are under way to address these issues. For example, OSFI has undertaken a training needs analysis and published a new learning guide; is identifying core competencies and developing a career management structure; and is reviewing its separate employer status to determine if the flexibility currently provided is sufficient or if other avenues should be explored. Having taken these first important steps, in our view it is now time for OSFI to "pause and reflect" as important decisions on human resource management are considered and made. In doing so, OSFI needs to document its analyses of relevant issues as clearly and completely as possible. This would serve two important purposes. First, it would help senior management review and challenge recommended courses of action and their alternatives. This would help to ensure that decisions are timely, that activities are in the right sequence and that OSFI management has full knowledge of what will be gained and what will be given up. Second, it would help senior management demonstrate, to other stakeholders such as regulated industries and government organizations whose support may be required, that proposed changes are necessary and appropriate.

OSFI has identified a number of human resource management issues it needs to address, but it is not yet able to demonstrate how well its activities will resolve them.

Need for improved tie-in to OSFI's vision for the future

The need for a longer-term and 30.35 more strategic approach to human resource planning. Because of the importance of OSFI's regulatory responsibilities and the essential nature of the services it provides, it is essential to ensure that qualified staff are available in appropriate numbers. The skills required by the organization need to be continuously assessed against available resources, and requirements determined through objective research. Depending on its future regulatory strategy, OSFI could require staff in significantly different numbers with different sets of skills. Furthermore, because many of the issues facing OSFI will not be resolved in the short term, a longer-term and clearly articulated approach needs to be developed.

30.36 The documents we reviewed showed activities planned for the current year only. Linkages were not clearly articulated between activities proposed or under way and OSFI's vision of its human resource management in the future, given the changes occurring in its environment and their impact on its regulatory strategy. Furthermore, OSFI needs to review its allocation of the priority of various projects to ensure that they are well integrated and conducted in the optimum order while taking into account operational priorities, such as staffing vacant positions. Seven human resource projects we reviewed had an A priority the highest — all with completion dates of April 1998 or earlier. Two had a B priority, but also had completion dates of April 1998 or earlier. In our view, it will be difficult for OSFI to successfully complete all of these projects simultaneously, especially as some are interrelated.

**30.37 OSFI has taken some steps in the right direction.** OSFI is devoting significant efforts to improving its

planning and the integration of the human resource management function with its Strategic and Business Plans. It believes that, once completed, these steps will provide a longer-term, more strategic approach that will respond to its regulatory strategy in the future.

30.38 OSFI should ensure that its human resource management activities are clearly linked to its vision of the future. In particular, OSFI should ensure that:

- the development of human resource policies and systems is guided by a clear definition of the way it expects human resources to be managed in the longer term; and
- priorities allocated to human resource projects optimize the sequence and integration of the various projects while taking into account operational priorities such as staffing vacant positions.

Some human resource issues require more thorough, documented analysis

30.39 Further developing the human resource framework: considering all options. Of particular importance is the need for OSFI to continue to develop its human resource framework and systems to provide a proper balance among possibly conflicting objectives, such as flexibility, service quality, maintaining independent, professional working relations with the financial institutions it regulates and providing employees with rewarding experiences and careers. OSFI already has significant authority to deal with what it considers its most problematic human resource concerns, and has recently begun to make use of that authority. For example, in 1996 OSFI began a classification study with the intentions of making more use of its authority to evaluate or classify positions and developing a compensation policy that would enhance the recruitment and retention of staff. Because some of the options it is contemplating could require

OSFI has significant authority to deal with its most problematic human resource concerns

A substantial number of positions left unfilled could seriously affect OSFI's ability to meet its objectives.

OSFI has not taken advantage of some available options to help achieve its staffing objectives.

changes in its legislation, OSFI needs to ensure that decisions are supported by documented analyses of both the costs and benefits of the various alternatives available.

Analysis of recruiting efforts. In a number of documents we reviewed, OSFI stated that chronic vacancies were responsible for delays in examinations and in issue analysis. Vacancy rates were especially high in examiner and support staff positions in Toronto. For example, at the time of our audit, 12 of the 20 life insurance examiner positions were vacant and managerial staff were performing examiners' work. In addition, OSFI reported a significant number of term or acting appointments. To the extent that a substantial number of positions are not filled, OSFI's work and its ability to meet its objectives could be seriously affected. In addition, the use of higher-level employees to perform lower-level duties impacts on staff utilization rates. motivation, and cost effectiveness. OSFI reported that non-competitive compensation was one of the major reasons for the loss of valuable employees and that non-competitive salaries and limitations imposed by the Public Service Employment Act were major reasons for difficulties in recruiting qualified staff.

30.41 We found that, while OSFI produces monthly establishment reports showing vacancies and staff movements, no summary report was available on the length of time it has taken to fill various positions, the reasons for any delays, and the impact this had on OSFI's operations. In addition, no detailed analysis of turnover was readily available.

30.42 In the sample of files we reviewed, we found that competitions for professional staff had taken some time to run their course. However, difficulties in identifying suitable candidates and filling vacant positions appeared to be attributable less to legislative requirements than to OSFI's internal

processes and the fact it had not yet taken full advantage of the considerable authority available to it. We also found that despite concerns about salary levels and although it has referred to broader surveys of the financial industry, OSFI has not done a salary survey since 1989–90 in accordance with its decision to comply with government policy on salary freezes in recent years. OSFI needs more concrete data to demonstrate that remuneration levels have had a negative impact on its ability to achieve its staffing objectives and that it needs special flexibility in salary levels.

- **30.43 Options that could help.** We found that OSFI has not taken advantage of some options available to it that could assist in expanding the pool of potential candidates and achieving its staffing objectives. These include, among others:
- enhancing its visibility as an employer of choice, by identifying and communicating, in the appropriate media, unique characteristics that OSFI possesses and that are liable to interest potential candidates, such as the opportunity to acquire an overview and understanding of financial institutions as a whole; and
- the development of an appropriate recruitment strategy related to its new mission, strategic objectives and goals that could then serve as a basis not only for recruitment but also for an approach to professional development. This could include decisions on such matters as whether to develop and maintain in-house expertise or hire experts on contract instead; recruiting recent university graduates or co-op students for a specified period of time; and recruiting retired people with experience in financial institutions.

# 30.44 Analysis of retention efforts. Management has expressed concerns about losing high-potential employees relatively soon after hiring them. However, OSFI does not produce or analyze profile reports on employees. Such profiles could include length of

service in a job, in the sector, and in OSFI. as well as information on competencies. performance and potential. In our view, in the absence of rigorous, documented analyses, it will be difficult for OSFI to demonstrate persuasively whether the loss of competencies or of high-potential employees is a systemic problem or is related only to a few cases, whether pay levels are the causal factor, or whether retention problems occur in specific locations only. The problem may be complex, and may be affected by such factors as the size of the organization. opportunities for promotion or job rotation, and other pressures.

#### 30.45 OSFI should ensure that:

- changes it makes in its human resource management framework or in recruitment and retention strategies are based on rigorous, documented analysis; and
- its analyses consider the costs and benefits of alternative courses of action in light of its mission, strategic objectives and vision for the management of human resources in the future.

# Importance of staff skills and professional development

30.46 Skills development essential. OSFI recognizes that learning activities are an essential business investment of time and money and that they can contribute to the accomplishment of strategic objectives as well as to the personal goals of employees. It also recognizes that the work environment must support a culture of continuous learning — one that encourages among staff a shared responsibility for learning, and provides employees with equitable access to learning activities related to their job requirements and career aspirations.

**30.47** Initiatives to address concerns. Nevertheless, OSFI officials expressed concerns about the need to have the highly

qualified, up-to-date staff necessary to keep pace with the rapid changes in the industry. In part this was identified as a recruitment issue, but it is also related to OSFI's ability to provide a learning environment and training opportunities. A number of initiatives have been undertaken to address this. For example, OSFI has identified continuous learning as an important part of its strategic management; allocated three percent of its salary budget for professional development and training; and developed a learning guide and undertaken a training needs analysis of individuals. It has also sent employees on training programs in such areas as change management, has established a self-learning centre, and is designing a career management structure. OSFI has informed us that it is beginning to obtain feedback on individual courses and on the impacts of on-the-job training.

30.48 Technical training needs more emphasis. We found that additional work needs to be undertaken to arrive at a better balance between technical training needs identified from a strategic or corporate perspective and training needs identified through employee feedback or within divisions.

30.49 There is also a need to ensure better linkage between identified training needs and actual training delivered or undertaken. At the conclusion of our audit, it was unclear on what basis training was allocated to staff. OSFI needs to get a clearer picture of all the types of training and learning opportunities provided to its employees. It recognizes that it can maximize the return on its investment in learning through better tracking of training initiatives, and is starting to monitor initiatives and projects in that light.

30.50 OSFI should develop mechanisms to ensure that the organization's training and learning needs are met and controls are in place OSFI needs highly qualified, up-to-date staff to keep pace with the rapid changes in the industry.

> that will maximize the return on its investment in learning.

### **Insurance Supervision**

30.51 Life Insurance Division. The Life Insurance Division has overall responsibility for the supervision of federally registered life insurance companies, branches of foreign insurance companies, fraternal benefit societies and branches of foreign fraternal benefit societies. As of 31 December 1996, as Exhibit 30.4 shows, there were 128 federally registered life insurance companies (57 federally incorporated and 71 foreign companies) and 28 fraternal benefit societies (13 federally incorporated and 15 foreign societies). The Division includes the following sections: Operations Analysis, Corporate Analysis, Actuarial Analysis, Examinations, and Securities Administration.

30.52 OSFI is the court-appointed liquidator for the winding-up of most of the federally incorporated insurance companies in liquidation. OSFI told us

that liquidations are managed by professional liquidators selected through a competitive process, in consultation with the industry and policyholder protection fund managers. It also told us that it carries out validation work to control and supervise the liquidations. As noted in the Scope section of About the Audit, we did not audit the liquidations operations of OSFI.

30.53 Property and Casualty Division. The Property and Casualty Insurance Division (P&C) has overall responsibility for the supervision of federally registered property and casualty insurance companies and branches of foreign insurance companies. As of 31 December 1996, there were 97 companies incorporated in Canada and 126 foreign companies operating on a branch basis (Exhibit 30.5).

30.54 The Property and Casualty Insurance Division includes the following sections: Operations Analysis, Corporate Analysis, Examinations, Liquidations (for both life insurance and property and casualty insurance companies) and Actuarial Affairs. In this Division, the

Exhibit 30.4

Life Insurance Companies and Fraternal Benefit Societies 1996

	Number of Companies	Assets Supervised by OSFI			Assets outside Canada Not Supervised by OSFI (\$ billions)
		Assets in Canada (\$ billions)	Assets out of Canada (\$ billions)	Total assets supervised by OSFI (\$ billions)	
Canadian companies	70	120.7	111.1	231.8	119.7
Foreign companies <sup>1</sup>	86	34.8	0	34.8	1544.6 <sup>2</sup>

Source: OSFI

Notes:

<sup>2</sup> As reported to OSFI by the companies

<sup>&</sup>lt;sup>1</sup> Foreign companies operate in Canada as branches or subsidiaries of the parent company.

actuaries also perform the actuarial examination function.

30.55 OSFI is a leading regulator. Insurance companies we interviewed were unanimous in their view that OSFI's regulatory practices are further advanced than those of other provincial, federal or national regulators they deal with. Other regulators throughout the world visit OSFI frequently to study the Canadian regulatory framework. Many other regulators are only now adopting the integrated regulatory framework, described in the Introduction of this chapter, that OSFI has had in place for the past few years. For example, Ontario announced in the spring of 1997 that it intends to amalgamate its Insurance and Pensions regulatory bodies.

A need to implement the risk assessment and risk management framework

30.56 OSFI has made progress in implementing the guide to intervention. OSFI introduced a new rating system for insurance companies in 1995–96 that follows its guide to intervention for insurance companies (Supervisory Guide

Applicable to Federally Regulated Insurance Companies). The system assigns a "stage" rating to a company on a scale of 0 to 4: 0 indicates no problem; 1 is an early warning of some deficiencies: 2 indicates risk to financial viability or solvency; 3 notes that future viability is in serious doubt; and 4 means the company is not viable or insolvency is imminent. The guide sets out the criteria for rating a company at each stage as well as the actions expected of OSFI and company management. For the life insurance industry, the guide also includes the actions expected of CompCorp, the compensation fund that protects policyholders if a life insurance company fails. OSFI has improved the transparency of the supervisory framework by distributing the guide to all regulated insurance companies. After their review of annual filings, OSFI analysts rate the companies and then revisit the ratings quarterly and report the results to OSFI senior management.

**30.57** In our review of files, we found that OSFI's life insurance analysts generally do a thorough analysis of company filings, appointed actuaries' reports and DCATs (Dynamic Capital

Other regulators throughout the world visit OSFI frequently to study the Canadian regulatory framework.

OSFI has made the supervisory framework more transparent by distributing its guide to intervention to all regulated insurance companies.

Exhibit 30.5

**Property and Casualty Insurance Companies 1996** 

	Number of Companies	Assets Supervised by OSFI			Assets Not Subject to OSFI Supervision (\$ billions)
		Assets in Canada (\$ billions)	Assets outside Canada (\$ billions)	Total assets supervised by OSFI (\$ billions)	
Canadian companies	97	30.0	.8	30.8	0
Foreign companies <sup>1</sup>	126	15.1	0	15.1	1,207.92

Source: OSFI

Notes:

<sup>1</sup> Foreign companies operate in Canada as branches or subsidiaries of the parent company.

<sup>&</sup>lt;sup>2</sup> As reported to OSFI by the companies. Foreign currencies were converted to Canadian dollars using rates as of December 1995.

Gaps in risk
assessment and risk
management could
prevent OSFI from
meeting its objectives
in the future.

Adequacy Test — a key test of the sensitivity of a company's capital and earnings to economic, business and actuarial changes). They analyze early-warning test results to identify questions and risks that require attention, and prepare pre-examination reports for examiners, reports to OSFI senior management and monthly reports to the Minister on companies where there is a risk to financial viability or solvency (rated at stage 2 or higher).

30.58 The Property and Casualty (P&C) division has made particularly good progress in providing guidance to staff, with the practical application of the *Guide to Intervention for Insurance Companies*; it could serve as a model for other OSFI divisions. The P&C Division analysts use an automated process that rates the companies using a point system based on ratios. The analyst reviews the results provided by the rating system and applies his or her judgment to determine whether or not to modify the suggested ratings.

30.59 Gaps could prevent OSFI from meeting its objectives. Although OSFI is a leader in developing regulatory practices, we found gaps in the implementation of its risk assessment and risk management framework that could prevent it from meeting its objectives in the future.

30.60 Difficulties with ratings. While most of the P&C automated system has worked well, we found one area that could be improved. The analyst is to provide a rationale if the rating suggested by the automated system is modified. We expected that there would be clear criteria to assist staff in making this judgment. However, we noted that the analysts' files did not always have a clear rationale for modifying the company ratings, or for the evaluation of qualitative elements such as the rating of management.

**30.61** We noted in minutes of its advisory committee meetings that OSFI has been hesitant to inform a company

when it moves to stage 3 because it believes moving a company to stage 3 could potentially result in public disclosure by the company, with significant impacts on public confidence and the viability of the company. It is concerned that public disclosure will undermine the effectiveness and efficiency of its work. However, OSFI has advised us that it now informs a company whenever its rating moves up or down a stage, thereby improving the clarity of the message given to company management.

30.62 OSFI may be reluctant to rate companies at a level higher than stage 2. OSFI managers have noted that the rating is very much a question of judgment. However, in three of the cases we reviewed it was questionable whether, in not rating companies at the stage 3 level more promptly, OSFI had followed its guide to intervention. Any reluctance can reduce the effectiveness of OSFI's early warning system: companies rated at a lower stage than is warranted may not receive adequate attention.

**Examinations contribute to** 30.63 industry improvements. OSFI examination staff in Toronto, Vancouver, Winnipeg and Montreal conduct well-planned, systematic, thorough examinations of companies. Companies are selected for examination based on factors such as new incorporation, risk rating and size. During 1996, 50 percent of life insurance companies and 51 percent of P&C companies carrying on active insurance operations underwent an on-site examination. Examiners consider information from a variety of sources such as analysts' reports, prior years' management reports and files, external auditors' reports and files, minutes of boards of directors, press clippings, and rating agency reviews. They use some specialists such as actuaries, credit consultants or treasury specialists, as appropriate. At the conclusion of the examination they discuss their findings with company management, report to

OSFI senior management and to the company's audit committee, and follow up on responses to their recommendations. Companies we interviewed agreed that the process generally contributes to continuous improvement in industry management and compliance with the *Insurance Company Act* and regulations.

30.64 Life insurance examinations need to be better focussed. We found that examinations of property and casualty insurance companies are well focussed on the key risk areas. Examination plans, reports and files provide clear support and rationales for the work done.

However, in about half the life insurance cases we reviewed, it was not clear that OSFI had focussed its examination on significant risks. While there were no apparent gaps in the examination procedures, examiners may be doing more work than necessary in low-risk areas and consequently less in-depth work in higher-risk areas. We observed that examination procedures could be better tailored to the particular risks in each company. As well, files do not adequately document how the previous year's examination findings were taken into account in order to reduce work or focus on key areas.

30.66 We noted that a limited amount of time is spent looking at the future business viability of companies, while much of the life insurance examination resources are spent on reviewing mortgages. We question the need for such a detailed review, since OSFI told us that most life insurance companies now have adequate systems to monitor their mortgages. We noted that OSFI reviews strategic plans, but there is little evidence of links between that review and the review of a company's report on Dynamic Capital Adequacy Testing (DCAT). In our review of files, we found little evidence of discussions with senior company management about the impact of the strategic plan and DCAT on the future of

the company. Life insurance company managers we interviewed suggested that discussions with OSFI could help improve the examiners' focus on future viability as well as on key risk areas.

30.67 Although OSFI is placing reliance on the internal and external auditors, life insurance examination files do not contain a rationale linking specific work performed by the auditors to OSFI's examination procedures. Without this link, it is not always clear what work OSFI is relying on and therefore it is difficult to determine whether and how its examination procedures could be reduced or eliminated.

30.68 Focusing its examination efforts is particularly important given the significant constraints on OSFI's resources. As we have noted, at the time of our audit, 12 of the 20 life insurance examiner positions in Toronto were vacant.

30.69 Use of experts. OSFI relies on the work of the external auditors to assess the adequacy of the management information systems in the life insurance companies it examines. However, we found little documentation in the examination files to support OSFI's assessment of the readiness of many companies' systems for the impact of the Year 2000 systems changeover. (Interest charges, premium billings, dividend credits, etc. could be miscalculated if computer routines were to interpret year 2000 as preceding year 1999 by 99 years rather than following it by one year.)

30.70 OSFI has recognized the need for more expertise in the assessment of information technology. A recent OSFI study noted that in the future, examiners may be required to possess at least enough knowledge of the various systems and applications in use to judge their general adequacy and differentiate between those that minimize risk and those that create their own risk. Examiners may also have to exercise judgment in determining which potential problems they can address

Examinations are well focussed on key risk areas for property and casualty insurance companies, but less so for life insurance in about half the cases we reviewed.

A limited amount of time is spent looking at the future business viability of companies. OSFI has recognized the need for more expertise in the assessment of information technology.

Some regulators have moved to after-the-fact review and approval of some transactions for companies that are adequately capitalized and pose no risk to the system.

themselves, which ones require some additional expertise, and which require a great deal of additional expertise.

However, we saw little evidence that OSFI had considered these requirements. For example, there was no mention of them in operating plans. Industry representatives whom we interviewed agreed that OSFI could make better use of contracts to obtain expertise in this area as well as in other areas, such as the evaluation of actuarial reports.

30.71 In order to give credence to its guide to intervention for insurance companies, OSFI should develop a more rigorous system of determining a company's rating — one that consistently includes the views of analysts, examiners and actuaries. If the impact of public disclosure is a real concern, OSFI should pursue changes to the legislation or regulations to prevent such disclosure.

30.72 OSFI should continue to work with the property and casualty insurance industry to define standards of sound business practices for the industry.

30.73 To enhance its efficiency, OSFI should better focus its examinations of life insurance companies on the key risk areas and on the assessment of the future business viability of the company, and improve its use of consultants with expertise in areas such as information technology and actuarial reports.

**Avoiding overregulation** 

30.74 Approval process is slow despite OSFI's quick response. Industry representatives we interviewed told us that OSFI's corporate analysts are well respected for responding promptly to company requests for approvals of acquisitions, asset transfers, reinsurance or other matters requiring OSFI's or the Minister's approval. However, in our review of files we found that the myriad approval requirements make the whole

process immensely time-consuming, however promptly the staff act. Some other regulators have recently moved to after-the-fact review and approval of some transactions for companies that are adequately capitalized and pose no risk to the system.

30.75 Capital requirements for life insurance companies are complex. OSFI has established well-defined, risk-based capital requirement standards and it monitors compliance with them to ensure the protection of policyholders through adequacy of capital. The standard for life insurance companies is called the Minimum Continuing Capital and Surplus Requirement (MCCSR). MCCSR is a ratio calculated by the company in accordance with OSFI's instructions. Determining the MCCSR is a complex process that attempts to take into account most aspects of the company's operations. OSFI's guideline to the industry setting out these instructions has changed frequently since its introduction in August 1992. Company managers we interviewed had difficulties with the MCCSR, including the detailed, lengthy review process, lack of a standing committee to ensure ongoing consultation, inconsistencies with other national regulators and ambiguous wording subject to misinterpretation. OSFI intends to avoid any further changes until it has monitored the impact of the current MCCSR guidelines.

30.76 OSFI and the Department of Finance should closely examine the compliance requirements and consider alternative methods to ensure that any negative impact on companies is minimized.

Integration of work of actuaries, analysts and examiners

30.77 OSFI's Property and Casualty actuaries' work is well organized.
OSFI's P&C actuaries perform systematic, detailed reviews of claims reserves and unearned premium reserves. They use their software systems and company data

to calculate information for comparison with the company actuary's calculation. Subsequently, they judge whether any differences are material and need to be discussed. For priority companies, the reviews follow the examination schedule every year; the objective is to review other companies every two years. However, OSFI has not yet reached that objective. It has told us that of 238 companies, the P&C Actuarial Affairs Section reviews 60 to 70 a year.

30.78 OSFI's life insurance actuarial resources are limited. Our examination of OSFI life insurance actuaries' work in Ottawa and Toronto found that they do a competent, professional job of reviewing the work of companies' appointed actuaries (actuaries appointed by the company who have statutory duties under the Insurance Companies Act). However, the actuarial staff resources in Ottawa are very limited. They include only one manager, two fully qualified actuaries, one analyst and support staff. The Actuarial Examination Section has been without a Director for the past three years, since 1994-95. There is no actuarial manager for the Toronto actuaries; all four actuarial examiners report to the Acting Director. Examinations. Actuarial staff in Toronto are involved in many aspects of the examination function beyond a review of the appointed actuaries' work, OSFI recognizes that it does not have the resources to do in-depth analyses of all actuarial reports.

**30.79 Role not clear.** The role of OSFI actuaries and the use made of their work are not clear. OSFI life insurance actuaries in Ottawa set up their own rating system for company reserves, independent of the rating system used by OSFI analysts. The actuaries' system rates the reserves on a scale of 0 to 3 rather than 0 to 4.

**30.80** Actuarial work not integrated. In our review of both life and P&C examiners' and analysts' files, we found little evidence of attention to the work of

OSFI actuaries. Examiners and analysts concentrate on other matters, or feel quite confident about reviewing the work of the appointed actuary themselves. We also noted that the actuaries' files indicated little exchange of information with the examiners and analysts. During 1996–97. the life insurance actuaries in Ottawa reviewed approximately 100 actuarial and DCAT reports and those in Toronto reviewed approximately 30 such reports. In our review of OSFI's files, we noted that the actuaries send a copy of their reports to the analysts. However, we found little evidence that analysts consulted with the actuaries or considered the information provided in their reports before rating the companies.

**30.81** In our view, the examiners and analysts could gain a better understanding of a company and its risks from consulting with and seeking the advice of the OSFI actuaries on a regular basis.

30.82 Work of analysts and examiners sometimes not well co-ordinated. OSFI management told us that analysts consult with examiners when determining company ratings. However, we rarely found evidence of consultations in the files we examined, or in our discussions with examiners. In one case we noted, OSFI examiners and analysts had presented conflicting information to company management.

30.83 P&C division intends to improve. We found that P&C examiners do not always agree with analysts about company ratings. An April 1997 internal memo lists a number of companies to which the examiner and the analyst had assigned different ratings. However, by the end of our audit these inconsistencies had been addressed and a consensus reached on the appropriate rating. P&C division management told us it intends to implement a system of regular consultation.

30.84 OSFI should review the role of its actuarial staff and assess the level of resources needed to perform its

The role of OSFI actuaries and the use made of their work are not clear.

Until 1997, OSFI met infrequently with boards of directors of life insurance companies, other than those about which it had a significant concern.

Management reports were often issued four to six months after the examination.

regulatory role. It should improve the co-ordination of the work of actuaries, examiners and analysts.

Communication with companies needs attention

30.85 Companies want feedback. Adequate communication with supervised companies is important to ensure that they clearly understand OSFI's concerns. In addition, OSFI could provide value to the companies it regulates by giving them more feedback. The companies we consulted expressed a desire to learn more from OSFI about their performance in relation to that of their peers. They felt it would be particularly valuable to have information on whether actuarial reports prepared by the company actuary were more or less conservative than those of others in their peer group.

30.86 Frequency of meetings with boards of directors improving. Prior to 1997, OSFI met infrequently with the boards of directors of life insurance companies, other than those about which it had a significant concern. A list of meetings provided by OSFI showed that on average, it met with four boards of directors each year from 1992 to 1997. In early 1997, it began to increase this number by meeting with the boards of major life insurance companies and companies where findings are significant.

30.87 Communication of actuaries' findings. Findings by OSFI actuaries in Ottawa are usually not communicated to the companies' appointed actuaries. As we have noted, companies would like more feedback on the quality of their actuarial reports. Regular discussions between OSFI's actuaries and company actuaries could provide useful information to companies and help improve the quality of actuarial work.

**30.88** Examination reports slow and inconsistent. OSFI's reports to life insurance company management on

examination results are not timely; they are often issued four to six months after completion of the examination. While examiners meet with company senior management at the end of each examination to obtain its comments on their observations, it is only when the final version is issued that the audit committee of the board is informed of the findings and recommendations. Most companies we interviewed, in both life insurance and property and casualty insurance, felt that OSFI should issue its report within two weeks after completing the examination. They suggested that if there are complex. contentious or unresolved issues, these can be noted in the report as items to be dealt with at a later date. These issues are relatively rare and need not hold up the report.

30.89 Furthermore, the content of these reports is not always consistent. OSFI is aware that they sometimes include issues that are not important enough to warrant bringing them to the attention of the board of directors. It informed us that, in future, an experienced OSFI manager will review management reports prior to their release to companies to ensure consistent quality control.

30.90 Disclosing the stage rating. OSFI does not inform a company when it is first classified at stage 1. We feel it is important that management be made aware of OSFI's view of the increased risk at an early stage, consistent with its mandate to act in a timely manner. OSFI has told us that in the future, it will inform all companies as soon as they are rated at stage 1. It advises the company and the Minister when the company moves to stage 2 or above.

30.91 OSFI should increase discussion with insurance company officials to better understand the company, and communicate its findings on a more timely basis to achieve better relationships and encourage improvements in company operations.

Need for continuous, documented communication with other regulators

Increasing importance of communication with other regulators. A number of features of the insurance industry make it important that OSFI communicate on a regular basis with other regulators, both foreign and provincial. For example, revenue from non-traditional sources is increasing for life insurance companies; they may now enter into transactions that are regulated by provincial securities exchanges. Also increasing is the proportion of Canadian life insurance companies' total profits that comes from their foreign operations. Many insurance operations in Canada, both life and property and casualty, are branches or subsidiaries of large foreign companies, which makes it imperative to communicate with foreign regulators (Exhibits 30.4 and 30.5).

Little evidence of communication. In the files we reviewed, we found little evidence of communication with other regulators. Companies we interviewed said OSFI did not request copies of foreign regulators' reports, even when they were carrying out their examinations at the same time. During our file review we noted that in two cases, the foreign regulator advised OSFI that it had issued an Order of Supervision placing restrictions on the company's activities, and that no funds would be transferred to the Canadian branch. Although OSFI had been aware of problems with a branch of one of these foreign companies and had rated it stage 1, it had not initiated any communication with the foreign regulator of the company. A more consistent approach to communication with foreign regulators is needed.

**30.94 OSFI has taken some steps.** At a senior level, OSFI communicates informally with foreign regulators and participates actively in international organizations such as the International

Association of Insurance Supervisors. In December 1996, OSFI established the position of Special Advisor to the Deputy Superintendent of Policy. The Special Advisor is responsible for developing plans to improve relations with other regulators. OSFI told us a draft plan was prepared in May 1997.

30.95 There are a number of other, less formal measures that OSFI could take to improve communication. For example, it could request copies of all regulators' reports from the entities it examines and discuss with entity management the results of the other regulators' reviews.

30.96 OSFI should finalize and implement its plan to strengthen its relations with other regulators and should also pursue both formal and informal communications, focussing on incorporating specific entity information into the analyst's risk assessment.

# **Private Pension Plan Supervision**

30.97 Pension Benefits Division. The Pension Benefits Division is responsible for the supervision of pension plans registered under the *Pension Benefits Standards Act 1985 (PBSA)*. Like the insurance divisions, it has sections for analysis, actuarial review and examinations. However, at the time of our audit there were only two pension examiners in Toronto and one in Montreal. OSFI plans to reassign two examiners in its Vancouver office to carry out pension examinations.

30.98 Pension plans are contractual arrangements under which money is set aside during the working life of employees to provide them with income at retirement. There are nearly 16,000 registered pension plans in Canada today, covering over 5 million employees, or about 45 percent of all employed Canadians. Most of these plans are subject to provincial jurisdiction and are regulated by provincial authorities. Some 1,100

OSFI could take a number of other, less formal measures to improve communication.

It is important to have regular communication between OSFI and other insurance industry regulators, both foreign and provincial.

plans, covering a little over half a million members in total, are regulated by OSFI (Exhibit 30.6).

#### Continue to press for less overlap

30.99 Regulatory overlap is problematic. All jurisdictions, both federal and provincial except for Prince Edward Island, have enacted legislation governing the establishment and operation of pension plans. The requirements imposed by the various jurisdictions, while similar, are not identical. As a result, plans whose memberships cross jurisdictional boundaries find themselves subject to more than one regulatory authority and more than one set of regulatory requirements.

30.100 OSFI has taken steps to reduce overlap. To reduce the costs associated with regulatory overlap, OSFI has entered into agreements with provinces whereby it delegates authority to provincial regulators to supervise plans that have members who are subject to the *PBSA*, or accepts authority from the provinces to supervise plans with members who are subject to provincial jurisdiction. Currently, OSFI supervises some 25 pension plans on behalf of provinces. Supervision of approximately 124 pension plans has been delegated by OSFI to the provinces.

30.101 Reciprocal agreements do not reduce the largest part of the regulatory

burden. These reciprocal agreements reduce regulatory costs by enabling plans to register with and be supervised by one regulator only. However, the regulator of a plan with members in different jurisdictions must apply separately the legislative requirements of the jurisdiction governing each plan member. This system can reduce the cost of compliance, the largest part of the regulatory burden, only to the extent that regulatory requirements are the same across jurisdictions. Unfortunately they are not, especially following changes to both federal and provincial pension standards legislation in the mid-1980s.

30.102 Multilateral agreements would be better. A more promising way of dealing with regulatory overlap is the "multilateral agreement" concept currently being promoted by the Canadian Association of Pension Supervisory Authorities (CAPSA). Unlike the reciprocal agreements now in place, multilateral agreements would allow multijurisdictional plans not only to register with a single regulator but also to be subject to the legislation of that regulator alone, regardless of the jurisdiction applying to individual plan members.

**30.103** The compliance burden resulting from overlapping and inconsistent regulations has been a long-standing concern of pension plan sponsors and administrators. Despite recent initiatives

Exhibit 30.6

Retirement Income Plans, Assets and Membership 1994

Source: Statistics Canada, Canada's Retirement Income Programs: A Statistical Overview (Feb. 1996) & Trusteed Pension Funds (1994)

Source: OSFI records

Type of Plan	Number of Plans	Assets (\$ billions)	Members (thousands)
CPP/QPP	2	54	12,912
RPP			
Regulated by OSFI <sup>1</sup>	1,100	45	501
Regulated by others	14,649	286	4,714
Total RPP	15,749	331	5,215
Federal government employee plans	20	122	459
RRSPs	_	182	5,110

through CAPSA and other forums, industry watchers and the industry representatives we interviewed say the situation is not getting better. As one of the major regulators of pension plans in Canada, OSFI can play a leading role in turning this situation around, by encouraging greater consistency in regulatory standards across jurisdictions and less overlap in supervisory requirements.

30.104 As part of its role in promoting greater consistency in the regulation of pension plans across Canada, OSFI should work actively with provincial regulators to promote the adoption of the multilateral agreement concept.

30.105 OSFI's focus is changing. The key objectives of OSFI's supervision of pension plans are to ensure that plan members can be reasonably confident that they will receive the benefits promised to them, and to monitor compliance with the *PBSA*. A major focus of OSFI's regulatory activities to date has been on verifying whether plans comply with *PBSA* provisions and attendant regulations. This is a time-consuming and costly exercise—and in OSFI's view, not particularly useful.

30.106 Plans for improvement. In December 1996, OSFI developed a draft guide to intervention for pension plans. similar to that for insurance. As part of its corporate plan for the next few years, OSFI has announced its intention to follow a more risk-based approach to regulating and supervising pension plans. It is currently in the process of developing a risk-rating system, an electronic database on pension plans similar to the existing database on insurance companies, and Standards of Sound Governance and Financial Practices. Once completed, these projects should make supervision of pension plans under the PBSA more effective and efficient.

#### Integrate monitoring and examination

30.107 Increasing use of examinations. On-site inspection of pension plans plays an increasingly important role in OSFI's approach to supervision. Prior to 1990, it carried out only two or three examinations a year. Since then, an objective of the Pension Benefits Division has been to complete 40 to 60 examinations each year. In practice, the actual number of examinations carried out each year has been in or below the lower part of this range.

30.108 Examinations and monitoring processes need improvement. The increased reliance on on-site inspections over the past several years has proved useful. However, our review of pension files revealed the same types of problems as we found in the insurance area quality controls and attention to actuarial information need improvement. For example, the rationale supporting the risk rating of a pension plan was not evident. In fact, each analyst had his or her own risk-rating system and there was no evidence that senior management reviewed or approved the ratings. The implementation of OSFI's new guide to intervention for pension plans is expected to remedy this problem. We also found little evidence of the development of systematic action plans for dealing with troubled pension plans, and examination reports to plan administrators were not timely.

**30.109** As in the Insurance Division, our file examination found little evidence of communication among pension plan analysts, actuaries and examiners. The examination process could be made more effective and efficient by integrating the monitoring and examination functions at OSFI.

**30.110** Increased participation of OSFI's Ottawa analysts in the examination process could enhance communication between examiners and analysts, sharpen

OSFI can play a leading role by encouraging more consistent regulatory standards across jurisdictions and less overlap in supervisory requirements.

Examination and monitoring processes need to be enhanced.

The guide to intervention for pension plans is a step in the right direction.

the focus of examinations, and cut down the time required to be on-site.

30.111 OSFI does recognize shortcomings in the existing examination process. It is planning to rectify them by narrowing the scope of examinations to areas sensitive to plan solvency and by allocating more of the examination work to analysts, actuaries and other non-examiner staff at headquarters.

30.112 In its ongoing review of the existing supervisory process for private pension plans, OSFI should encourage a closer integration of the monitoring and examination functions in the Pension Benefits Division. It should pay more attention to quality controls and actuarial information and strive for greater consistency in the risk-rating process.

### Conclusion

30.113 Accountability framework has improved. We concluded that OSFI has achieved a clear accountability framework for its insurance operations by establishing a mandate, strategic objectives, standards of sound business practice and a guide to intervention. Plans are in place to develop a similar framework for pension plans. OSFI is continuing to enhance the framework by developing performance measures, and has begun to address the issue of compliance in a more comprehensive way by stressing company management's responsibility for compliance with Acts and regulations.

30.114 Risk assessment systems need to be enhanced. Through the establishment of standards and guides, OSFI has improved its systems and procedures for assessing the risk that individual entities pose for policyholders or plan members, although implementation is uneven. OSFI's increased emphasis on key risks and solvency issues helps it to detect problems early. However, its ability to respond would be improved if operating

units were better integrated and if co-ordination and communication with regulated entities and with other regulators were improved.

30.115 Human resource management requires better analysis and links to future strategic direction. OSFI management has expressed concern about difficulties in obtaining qualified staff with appropriate skills. A number of initiatives are under way to try to address these concerns. However, OSFI needs to clearly set out its assessment of these initiatives, based on well-researched information and a clear rationale linking them to its regulatory strategy for the future.

30.116 OSFI is making progress on meeting needs for the future. OSFI has conducted a number of studies in the past year covering potential risks facing the financial services industry in the future. While it has incorporated the findings of some studies into its operations, in other cases the use of study results has been less evident. OSFI has plans in place to meet the challenges of increased industry complexity and globalization, through harmonization of regulations and both formal and informal sharing of information with other regulators. However, it needs to pay more attention to regulatory incentives that enhance the efficiency of the regulatory system.

30.117 Continuous improvement needed in response to increasingly rapid changes in the financial services industry. OSFI has made significant progress since its inception 10 years ago. Its philosophy and processes are becoming increasingly sophisticated. Although OSFI meets the needs of today's environment, it nevertheless needs to address important gaps that could affect its ability to meet its objectives in the future.

OSFI's response: The Office of the Superintendent of Financial Institutions (OSFI) is in general agreement with the observations and findings arising out of the audit of OSFI's insurance and pension operations.

While there are a few conclusions that, in our view, miss the mark, we agree with the majority of the audit findings and accept the recommendations resulting from them. Indeed, in many cases, the recommendations support initiatives already under way within OSFI.

Beyond the audit's specific conclusions, we believe that the chapter fairly portrays the progress we have made to date in enhancing our regulatory and supervisory processes, while highlighting the significant challenges that we face in keeping pace with the rapid changes taking place within the financial sector.

The chapter is particularly supportive of the work under way within OSFI to develop an accountability framework, including a mission statement, strategic objectives and performance measures. We wish to acknowledge the advice and encouragement we are receiving from the Office of the Auditor General as we work to develop standards in a field in which few precedents are available.



# **About the Audit**

# **Objectives**

We developed our detailed audit objectives and audit criteria in light of the changes in the legislative framework and the increasing risks to the entities OSFI regulates, and ensured that they were related to OSFI's strategic objectives and were future-oriented.

The objectives of this audit were to determine whether OSFI, with respect to its insurance and pensions operations:

- 1. has a clear mandate, roles and responsibilities as well as adequate quality controls and reporting to meet its accountability requirements, and more specifically whether it:
  - knows if its objectives are met in a cost-effective manner for the entities regulated; and
  - has complied with the requirement to administer respective Acts and regulations governing its operations.
- 2. has adequate and efficient systems, procedures and capabilities to safeguard policyholders and plan members from undue loss, and more specifically whether it:
  - has adequate resources, including staff, to carry out its work;
  - has developed and implemented the appropriate systems and practices to assess the soundness of insurance companies and pension plans under its jurisdiction as well as their compliance with relevant Acts and regulations;
  - has the ability to detect early, and respond to, deteriorating situations; and
  - is effectively communicating and sharing information on a timely basis with related organizations.
- 3. contributes to public confidence by anticipating future challenges and adjusting its activities to meet them.

# Scope

Our audit covered OSFI's supervision of insurance and pensions, concentrating mainly on operations during 1996. We completed our field work at the end of May 1997. However, we considered information available up until completion of the audit report on 15 September 1997.

While our focus was on OSFI's Operations Sector, we also covered policy and corporate services where they have a major impact on Insurance and Pension operations. OSFI's own financial operations are audited annually during our public accounts audit. In 1994, we carried out a more detailed audit of OSFI's financial management for public accounts purposes. Based on our work, we consider financial management and control in OSFI's own operations a low-risk area and did not cover it in the scope of this audit.

We did not audit OSFI's activities with respect to the liquidation of insurance companies. In our 1986 audit of the Department of Insurance, the Department provided us with information on the process for handling insurance company liquidations and we commented on it. During the present audit, OSFI pointed out, and we concur, that the audit of the liquidation function is beyond our mandate. The Superintendent has been appointed, under authority of the Winding Up Act, as liquidator for many failed insurance companies. In this role, he is accountable to the courts. As a result, we were not able to examine whether the Superintendent, in his role as liquidator, has met the requirements under the OSFI Act to protect policyholders while taking into account impacts on competition (under recent changes to the legislation, the Superintendent will no longer be appointed liquidator). As a consequence of these limitations, we were not able to determine whether OSFI's monitoring under the new regime will be sufficient to protect policyholders. At the time of our audit, the Superintendent was in the process of liquidating 10 property and casualty insurance companies and two life insurance companies. OSFI was unable to provide us with the total estimated costs of liquidating these companies, including agent and legal fees and administrative expenses. The cost from the date of liquidation to 31 March 1997 amounted to \$88.6 million, of which \$46.2 million had been recovered from the estates of the liquidated companies. Costs that are not recovered from estates will be recovered from the insurance industry. The costs incurred in 1996–97 totalled \$1.9 million.

Our audit also covered the Office of the Chief Actuary. However, certain parts of his work were excluded. The Auditor General's annual audit of the government's financial statements includes the Chief Actuary's valuation of government employee pension plans. Also, our audit of CPP Disability, reported in September 1996, included the valuation of the CPP. Therefore we did not examine the adequacy of actuarial valuations performed by the Chief Actuary.

## **Approach**

Our audit included the review of monitoring, examination, corporate analysis and actuarial files in Ottawa, Toronto, Winnipeg, Vancouver and Montreal. We examined all companies and pension plans rated at stage 1 and higher. In determining whether OSFI met the audit criteria, we examined nearly 250 files. We also conducted interviews with OSFI staff at headquarters and in the regional offices, at various levels. We conducted interviews with senior management and industry representatives of 32 life insurance companies, property and casualty insurance companies and pension plans. We also reviewed more than 200 documents including OSFI publications, internal audit reports, industry publications, Acts and Regulations and OSFI Guidelines for Industry.

#### Criteria

#### Risk assessment

OSFI should have in place an effective process to guide staff in the work to be done that results in the timely identification of solvency and compliance problems.

OSFI should use a risk-based approach to identify companies/plans that require in-depth work and to identify key areas in a company/plan that require further investigation to ensure that potential problems are properly understood and evaluated on a timely basis.

There should be clear and timely communication of requirements and findings, with the company/plan, OSFI staff in related sections and other agencies or regulators.

Office of the Superintendent of Financial Institutions — Insurance and Pensions

#### Risk management

There should be a framework for intervention that is well understood by OSFI and regulated institutions.

There should be an action plan that considers possible remedies to a problem and ensures that they are corrected in a timely manner.

#### **Anticipation of future challenges**

OSFI should have a plan and process for system-wide and cross-system studies and use the results in other relevant areas such as examinations, monitoring and rulings, to identify potential problems and to ensure that its processes will be adequate in the future.

#### Mandate and accountability

OSFI should have a clear mandate, converted into a clearly articulated mission with specific goals, objectives and plans.

OSFI should have in place effective agreements with provinces, related federal departments and guarantee agencies. OSFI should have in place documented procedures for liaising with foreign regulators. The agreements and procedures should provide a clear understanding of each organization's roles and responsibilities. The agreements and procedures should also provide an operational framework that includes the timely sharing of information and the best use of legislative powers, recognizing the limitations imposed by other regulatory frameworks.

OSFI should periodically measure its results against predetermined performance criteria and report those results to the Minister, to Parliament and to other stakeholders.

OSFI should make use of key performance measures, including quality control processes, to improve its operations and accountability.

OSFI should identify the key requirements of respective Acts and regulations and ensure that it meets those requirements. OSFI should identify on a timely basis the adequacy of the existing legislation and regulatory policies, including any gaps.

OSFI should make use of information technology for cost-effective operations.

#### Human resource management

OSFI's organization structure and delegated responsibilities should permit the effective realization of its mandate. OSFI should have adequate staff with the necessary skills to perform the work required.

Office of the Superintendent of Financial Institutions — Insurance and Pensions

## **Audit Team**

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This December 1997 Report comprises 16 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, October and December 1997 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.



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# **Chapter 31**

**Revenue Canada** 

The Financial Management Regime

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Assistant Auditor General: Shahid Minto Responsible Auditor: Basia Ruta

# **Revenue Canada**

# The Financial Management Regime

### **Main Points**

- 31.1 Revenue Canada's 40,000 employees dispersed across 800 offices collect about \$850 million and disburse some \$425 million on average each working day.
- 31.2 The sheer size of Revenue Canada, the importance of its contribution to sustaining other government programs and its high visibility to taxpayers require a strong commitment to effective financial management. In the aspects of financial management examined during our audit, we found some areas of strength and no areas of neglect. We also noted several areas in need of improvement. Revenue Canada has gone through a period of tremendous change, both organizational and legislative. It is now at a stage of maturity where it needs to give more attention and a higher priority to financial management.
- 31.3 The Department has been proactive at establishing corporate plans and strategic documents that are linked to government objectives and priorities. Management agreements are being used to help promote a common vision and strengthen managers' accountability.
- 31.4 Revenue Canada's performance in the prompt deposit of billions of dollars of payments it receives from taxpayers at its offices and ports is generally satisfactory. Our tests show that the vast majority of taxpayer remittances are deposited by the next business day. Still, opportunities exist to improve departmental performance in this area and generate several millions in potential interest revenue for the government each year.
- 31.5 Revenue Canada's practices in the monthly reporting of revenues require more rigour. Basic accounting systems in support of \$18 billion in annual deposits by Customs need to be modernized considerably.
- 31.6 Deficiencies exist in other formal systems and practices pertaining to key areas of financial management. Informal information systems, proxy measures or other mechanisms are being used in an effort to bridge those deficiencies. Some of the shortcomings have a multiplier effect on financial risks to the public purse, and impact on other federal-provincial programs whose benefits or credits are tied to information contained in Revenue Canada's systems. Departmental initiatives are either planned or under way to address some shortcomings.
- 31.7 We have significant ongoing concerns about the reliability of information meant for use in monitoring and analyzing program statistics, trends and performance. As Revenue Canada becomes increasingly reliant on using information in diverse ways to monitor and support its programs, there is a crucial need to clean and purify data to remove any inaccuracies and ensure that they are in an appropriate form for analysis.
- 31.8 Although responsibility for financial management is shared and decentralized among headquarters, program and regional operations, Revenue Canada does not review or co-ordinate systems and practices Department-wide. Nor has internal audit been used effectively to provide independent overall assurance on the state of financial management and control across the Department.



## Introduction

Few organizations compare with Revenue Canada in the size and range of financial transactions

Few organizations compare with Revenue Canada in the size and range of financial transactions that typify its daily operations. These transactions cut across virtually every program and activity the Department administers. During 1995-96, Revenue Canada collected over \$212 billion and spent about \$2 billion to run its own operations. As illustrated in Exhibit 31.1, it disbursed more than \$45 billion in the form of federal tax refunds, drawbacks and social benefit payments to millions of Canadians. This was in addition to over \$62 billion in direct cash transfer payments to the provinces, the Employment Insurance Account and the Canada Pension Plan. In total, these transactions represent about \$850 million collected and some \$425 million disbursed on average each working day.

31.10 Not reflected in these figures are other sizeable financial operations for which Revenue Canada is responsible. They include, for example, tens of billions of dollars of indirect annual expenditures in the form of assessed tax deductions and credits on taxpayer returns — that is, tax expenditures. They also encompass the Department's \$9 billion inventory of tax debts, and an estimated \$800 million investment in facilities and other capital assets.

# For Revenue Canada, a strong financial management regime is crucial

31.11 The sheer size of Revenue Canada, the importance of its contribution to sustaining other government programs and its high visibility to taxpayers require a strong commitment to effective financial management and control of its expenditures, revenues and assets. The ability to recognize and implement opportunities to enhance efficiency and cost-effectiveness in operations can mean millions of dollars in savings or additional revenue for the government. Timely identification and correction of even minor inefficiencies or of extremely small rates of leakage in revenues or expenditures could translate into millions of dollars of cost avoidance or increased revenues. For example, in 1996 we reported that the Department's efforts to promote direct deposit of benefit payments were estimated by the government to have generated some \$7 million in annual savings on postage, banking and paper costs. Conversely, in 1994 we reported that each one-cent drop in average cash recovered for each dollar of income tax debt resolved cost the treasury \$34 million, and that opportunities existed to enhance

Revenue Canada
collects about
\$850 million and
disburses some
\$425 million on
average each working
day.

Exhibit 31.1

#### **Revenue Canada's Volumetric and Dollar Transactions**

- 21.8 million individual income tax filers
- 205,000 trusts
- 1.1 million corporations
- 2.4 million goods and services tax (GST) registrants
- 1.3 million employers
- 158,000 commercial importers
- 107 million travellers
- 23,000 registered pension and deferred profit sharing plans
- 74,000 charities
- \$258 billion in trade representing more than 30.9 million commodity declarations resulting from 10.9 million commercial entries
- 17.1 million public enquiries
- 467,000 Children's Special Allowance payments
- \$212 billion in gross receipts
- \$45 billion in tax refunds, drawbacks and social benefit payments
- \$62 billion in direct cash transfer payments to the provinces, the Employment Insurance Account and Canada Pension Plan

Source: Revenue Canada's 1997–98 Estimates, A Report on Plans and Priorities, and 1995–96 Performance Report – Revenue Canada

Given Revenue
Canada's sheer size,
even minor
inefficiencies or
extremely small rates
of leakage in revenues
or expenditures could
translate into millions
of dollars.

The revenue collection agency concept will create substantial additional pressures on financial management.

departmental performance in this area. In paragraph 31.88, we note that a discrepancy of less than one percent in cost estimates relating to two projects alone amounted to approval of about \$700,000 in excess funding. What these examples show is that, given the size of Revenue Canada's operations, individually the absolute dollar effects of factors such as errors, discrepancies and missed opportunities for enhanced efficiencies and cost-effectiveness are significant, and cumulatively they are potentially huge.

31.12 Exhibit 31.2 sets out the major elements of financial management. In our view, there are five elements that must be in place to achieve effective financial management. They are: appropriate systems; effective financial controls; effective measurement of results; objective analysis backed by accurate, timely, and relevant information; and necessary links from that analysis into departmental decision making and formal accountability structures.

#### Exhibit 31.2

#### **Financial Management Elements**

Financial management elements include, among other things, the systems, policies and procedures needed in an organization to provide reasonable assurance that:

- financial risks are appropriately identified and managed;
- relevant, accurate and reliable information is available to decision makers on a timely basis to understand the financial implications of decisions before they are made;
- assets and public money are properly safeguarded and protected against losses;
- money is expended and collected with due regard to economy, efficiency and effectiveness and in accordance with executive financial authorities, laws and principles;
- financial results are reliable, timely and accurately reported:
- · financial performance is appropriately monitored; and
- management is held accountable for the results it achieves.

# Taking note of Revenue Canada's daunting change environment

During the past several years, the Department has faced tremendous changes in both its legislated responsibilities and its organization, and continues to do so. In the fall of 1992, the announcement of the administrative consolidation of Customs and Excise with income tax operations turned Revenue Canada — almost overnight — into one of the largest federal government departments. Like other government entities, Revenue Canada had to reduce its spending and deal with the government's, Program Review exercise. Program Review confirmed the Department's mandate in all respects, and reduced its annual base funding by a few hundred million dollars. Throughout the past four-year period, many employees either were displaced or were placed in several interim and acting positions. New systems had to be introduced without disrupting regular operations. During that period, Revenue Canada also assumed new responsibilities formerly carried out by other departments, and entered into cost-sharing and partnering arrangements for either collecting the GST or distributing social benefits.

31.14 Currently, the Department is anticipating a period of further significant change as it deals with the government's stated intention to record taxes on some form of accrual basis and transform it into a revenue collection agency. If the revenue agency concept materializes, it will most certainly create substantial additional pressures on financial management.

# Progress made in issues raised by past audits

31.15 In the past several years, our audits of many of the Department's programs have reviewed aspects of financial management. Although a

number of our observations in those areas were positive, we also observed several apparent deficiencies, many with significant implications for the public purse, the management of the government's finances or the integrity of the tax base.

31.16 Chapter 18 of our October 1997 Report noted the Department's progress in dealing with our observations in the 15 audits we reported on from 1992 to the spring of 1996 inclusive. While we conclude in that chapter that we are generally satisfied with actions the Department has taken to bring about a number of improvements in almost all areas, much more remains to be done. Given the financial risks and the dollar amounts involved, sustained effort to resolve the matters still outstanding from our previous audits is essential.

#### Focus of the audit

31.17 Our objective for the audit was to determine whether, in the areas examined, the financial management regime in place was sufficient to provide adequate safeguards to minimize financial risks and protect financial assets, and sufficient to support management in its efforts to achieve its program objectives in an efficient and cost-effective manner. We considered, among other things, the Department's performance in dealing with financial management observations in our previous audits as well as in two of its key fiduciary responsibilities.

31.18 Our audit concentrated on Revenue Canada's financial management systems and practices in the period from the administrative consolidation of the two former revenue departments until June 1997. Further details on our audit scope, objectives and criteria can be found

in **About this Audit** at the end of the chapter.

# **Observations and Recommendations**

### **Key Fiduciary Responsibilities**

31.19 Two of Revenue Canada's key fiduciary responsibilities are to ensure the prompt deposit of billions of dollars of taxpayer remittances and to report to central agencies on revenues collected. We also considered Revenue Canada's performance in supplying other financial information to key stakeholders for input into tax policy or to support financial reporting requirements of the federal government.

Majority of tax payments are made directly at financial institutions and through electronic funds transfers

31.20 Cash management. As the primary revenue collection point for the federal government as well as most provincial governments, Revenue Canada is responsible for collecting over \$200 billion annually in customs, excise, income tax (federal and provincial) and GST, as well as Canada Pension Plan and Employment Insurance premiums.

31.21 Using 1995–96 figures,
Exhibit 31.3 shows that \$119 billion or
59 percent of overall tax payments are
made at financial institutions. A further
\$15 billion or 7 percent are transferred
directly from the taxpayers' banks to the
Receiver General through electronic funds
transfer. The balance, some 34 percent or
\$69 billion, is collected directly by
Revenue Canada at its offices and ports,
with \$4.6 billion of that amount, or 2
percent overall, collected by the Ministère
du Revenu du Québec on behalf of
Revenue Canada for GST in that province.

Exhibit 31.3

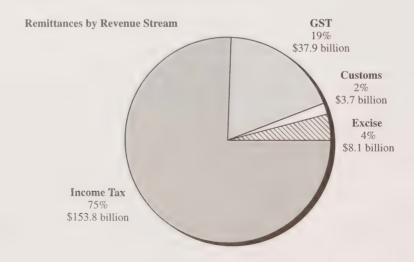
#### Profile of Remittances - 1995-96

Of the over \$200 billion in annual tax payments, 66 percent are made at financial institutions or through electronic funds transfer. Some 34 percent is collected directly by Revenue Canada at its offices and ports.

	Revenue Stream (\$ billions)					
Remitted through:	Income Tax	GST	Customs	Excise	Total	
Financial Institutions	104.6	13.7	_	1.1	119.4	668
Electronic Funds Transfers	15.0	-		_	15.0	66%
Revenue Canada						
Tax Services Offices	9.7	2.3		6.9	18.9	
Tax Centres	24.5		-	_	24.5	
Customs Offices	_	14.53	3.7	_	18.2	34%
GST Tax Centre	-	2.8	_	0.1	2.9	
Ministère du Revenu du Québec (MRQ) <sup>1</sup> – on behalf of Revenue Canada		4.6		_	4.6	
Totals	\$153.8 <sup>2</sup>	\$37.9	\$3.7	\$8.1	\$203.5	100%

Non-cash items such as source deductions for federal employees, offsets and credits, which make up \$8 billion of tax, are not included.

<sup>&</sup>lt;sup>3</sup>This amount represents GST on imported goods.



Source: Revenue Canada Financial Reports

<sup>&</sup>lt;sup>1</sup>A portion of GST collected by MRQ is remitted at financial institutions.

<sup>&</sup>lt;sup>2</sup>This amount includes provincial taxes collected.

31.22 The best scenario for cash management is to have tax remittances deposited in government bank accounts on the day they are received from the taxpayer. With the funds available for immediate use, the government can either avoid interest on short-term borrowing or earn interest by investing the funds.

31.23 Cash management also benefits from direct payment by taxpayers at a financial institution or through electronic funds transfer. As a result of agreements between the Receiver General and the direct-clearing financial institutions, if the funds are not transferred to the Receiver General the same day, the government will still earn interest on them, whereas amounts received at Revenue Canada but not deposited in government bank accounts the same day will not. Revenue Canada has arrangements in place to accept electronic funds transfers and to allow taxpayers to remit income tax, domestic GST, and excise at any branch of Canada's major banks and credit unions. However, for amounts levied by Customs, including GST on imported goods, there is currently no system for bank remitting. As for electronic funds transfer, the Department has indicated that brokers and importers can remit in this way but, except for one importer, none have arranged to do so.

31.24 We examined the extent to which legislation is supportive of bank remitting for each of the revenue streams, and the timeliness with which funds received directly at Revenue Canada offices are deposited. Regarding the adequacy of legislative support for bank remitting, we note that the Department of Finance is responsible for the related policy provisions embodied in legislation. However, Revenue Canada is expected to advise the Department of Finance on

suggested legislative changes as it deems appropriate.

Mandatory bank remitting for some revenue streams, but not customs and excise

31.25 While it is not mandatory for payment of corporate or personal income tax, the law requires that average monthly remittances of \$50,000 or more for source deductions by employers (the largest source for income tax) and remittances of \$50,000 or more for domestic GST be made at a financial institution. We found that income tax and domestic GST have high rates of bank remitting, compared with little or no bank remitting for other revenue streams, as shown in Exhibit 31.3.

Mandatory bank remitting provisions do not exist for customs payments, GST on imported goods, excise duties and levies. These represented some \$26 billion in cash receipts in 1995–96; only \$1.1 billion of \$8.1 billion in excise duties and levies (13.5 percent) were remitted directly at financial institutions on a voluntary basis. The balance of excise payments and all of customs levies, including GST on imported goods about \$25 billion in total — were paid at Revenue Canada offices. As noted in the preceding paragraphs, the Department has not made voluntary bank remitting possible for amounts levied by Customs. We note that almost 78 percent of income taxes were bank remitted in 1995-96 (statistic includes electronic funds transfers) compared with 13.5 percent of excise taxes.

31.27 Beyond cash management considerations, we are also concerned that the disparity across revenue streams in legal requirements for mandatory bank remitting impacts considerably on the fair and equitable treatment of taxpayers. Many monthly remittances by importers and brokers are in the tens of millions of

The best scenario for cash management is to have tax remittances deposited in government bank accounts on the same day.

There is currently no system that would allow taxpayers to pay at financial institutions amounts levied by Customs, including GST on imported goods.

Income tax and domestic GST have high rates of bank remitting, compared with little or no bank remitting for other revenue streams.

dollars, and several are in the hundreds of millions of dollars. For source deductions and domestic GST, such sums have to be paid by taxpayers at financial institutions — if not, they may be subject to penalties and/or interest. However, under existing legislation, importers and brokers are not faced with such penalties. Moreover, paying at Revenue Canada offices may result in a delay of a day or more before remittance payments are actually drawn from taxpayers' bank accounts. This provides an unfair advantage to importers and brokers in terms of cash flow or potential interest generated. The same inequities exist for those required to remit excise payments. There are similar inequities for personal and corporate income taxes: for income tax, as noted above, only source deductions are subject to mandatory bank remitting.

31.28 Since the administrative consolidation of the two former revenue departments, Revenue Canada has been proactive in suggesting legislative changes to harmonize provisions of the law across revenue lines. It has highlighted many inconsistencies, including those that pertain to mandatory banking requirements. Proposals for harmonizing legislation are in the hands of Finance.

31.29 The Department of Finance should seek legislative changes to have customs and excise payments, GST on imported goods, and personal and corporate income taxes be subject to mandatory bank remitting provisions comparable with those for source deductions and domestic GST, to ensure the fair and equitable treatment of taxpayers. As part of the exercise, it should also seek legislative changes to ensure appropriate penalty provisions in support of enforcement of mandatory bank remitting across revenue streams.

Department of Finance's response: The Department of Finance agrees in principle that it may be desirable to require large remittances of all types of revenue to be made at financial institutions. Finance is currently considering this issue with Revenue Canada through its broader review of interest and penalty provisions and will recommend appropriate legislative measures once the review is completed.

31.30 Revenue Canada should implement a bank remitting system for Customs as soon as possible to accommodate voluntary bank remitting, and ultimately mandatory bank remitting as approved by decision makers.

Department's response: The amalgamation of Revenue Canada, Taxation and Revenue Canada, Customs and Excise into one department provided the opportunity and the impetus to integrate all of the revenue programs it administers. This process of integration to develop a single or standard accounting system, which is at times referred to as re-engineering, began in 1995 and covers a period of several years ending in the year 2002. The capability to allow financial institution remitting for all revenue streams is a part of this initiative.

# Revenue Canada deposits majority of receipts by the next business day

31.31 With receipts of \$69 billion flowing through Revenue Canada offices for 1995–96 alone, timely deposits of receipts can result in several million dollars in additional interest revenue or, alternatively, in savings on interest expense for the government each year. Consequently, we expected that the Department would give strong direction concerning cash management in the field. While the Department has a clearly established policy that all offices and ports should schedule a bank deposit if total receipts for the day exceed \$500, it is less

The disparity across revenue streams in legal requirements for mandatory bank remitting impacts on the fair and equitable treatment of taxpayers.

clear about the standard of performance expected. For example, we found no expected standard of performance for the timeliness of deposits by Customs offices. For the rest of the Department, we found a policy calling for deposit of remittances within 24 hours during regular or peak periods, and the maximizing of same-day deposits. However, no performance targets were provided for same-day deposit.

31.32 We wanted to analyze the information generated by the Department to monitor its performance in timeliness of deposits, but found that existing reports were not relied on in the field and, in the case of deposits by Customs, that no reports were produced. Therefore, to assess Revenue Canada's promptness in depositing receipts, we selected sample items from either 1995-96 or 1996-97 to compare the date of remittance with the date of deposit. Because of differences in the systems used in the various business lines to process deposits, and the variation in the information they capture electronically from source documents, our approach to sampling varied. We did not test the GST remittances collected by the

Ministère de Revenue du Québec (not reflective of Revenue Canada's performance).

31.33 The results of our testing were generally satisfactory, notwithstanding the lack of effective cash monitoring systems in each revenue stream: between 22 percent and 26 percent of the dollar value of remittances in our sample were deposited the day they were received, and 76 percent to 100 percent were deposited by the end of the next business day (Exhibit 31.4).

31.34 We found that performance varied by month, by office and by revenue stream, suggesting that the high level of performance observed in some offices is more likely attributable to the level of understanding among Revenue Canada employees of the importance of making prompt deposits than to a comprehensive cash management regime. Also, internal audit's attention to aspects of cash management likely offsets to some extent the weaknesses apparent in day-to-day monitoring. Without vigilant monitoring and improvement of performance, and seeking out opportunities to improve

Reports generated by the Department to monitor the timeliness of deposits were not relied on in the field and, in the case of Customs, no reports were produced.

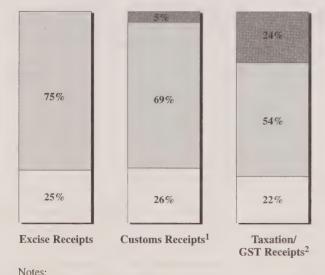


Exhibit 31.4

Remittances Received – Processing Time

**Processing Time (percentage)** 

Same Day Deposit

Next Business Day Deposit

Subsequent Days Deposit

Source: OAG sample of cash collections: Excise/Customs – 1995-96 year, Taxation/GST – April, August and October 1996

<sup>1</sup> Includes GST on imports

<sup>2</sup> Includes provincial tax collected

Without vigilant monitoring and improvement of performance, Revenue Canada risks forgoing several millions of dollars in potential interest revenue for the government each year.

In one case the full daily receipts of \$290 million were left undeposited for four days because the month-end fell on the Friday before a long weekend.

systems, Revenue Canada risks forgoing several millions of dollars in potential interest revenue for the government each year.

# Opportunities exist to improve performance

- 31.35 Our testing revealed that opportunities exist to improve cash management in cost-effective ways, using the existing systems. For example, we identified the following opportunities:
- Customs. Seven of the 37 randomly selected daily deposits were from one large Customs office. We found that no same-day deposits had been made on any of these seven month-end dates. In one of the seven cases, the full daily receipts of \$290 million dollars were left undeposited for four days because the month-end fell on the Friday before a long weekend. By way of contrast, most of the other offices included in our sample showed at least some same-day deposits, with a few offices showing same-day deposit for all receipts. The \$290 million left undeposited for four days translates into lost interest of between \$73,000 and \$178,000 at that one office. The interest lost by the failure to make any same-day deposits for all of the seven month-end dates in our sample from that office would amount to \$283,000 to \$690,000. As noted in paragraph 31.31, Customs has yet to clarify a standard of performance for promptness of deposits.
- Income tax and domestic GST. We took a sample of three months from 1996–97, excluding mail-in remittances at the GST processing centre. We found that the performance on same-day and next-business-day deposits varied significantly among offices, even in the same region (Exhibit 31.5). The overall rate of next-business-day deposit for each of the three months analyzed was considerably lower than required by departmental policy for Tax Centres and

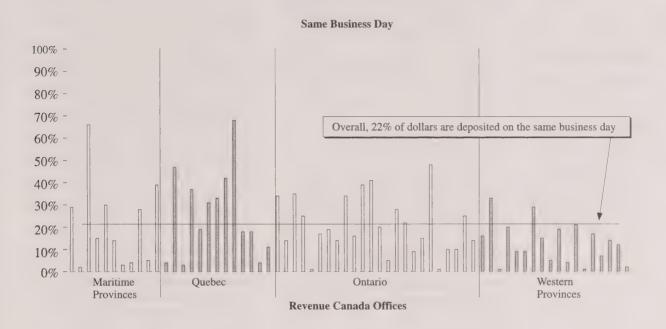
Tax Services Offices. The Department informed us that subsequent to our audit it issued a directive clarifying the policy to include an expected minimum standard of 90 percent processing by next business day. Of the three months tested, October was the only month in which the overall rate of next-business-day deposit would have met that revised standard. We noted that the proportion of remittances that was deposited by the end of the next business day was only 65 percent in April, compared with 82 percent in August and 90 percent in October.

Our analysis of the month of April, in which only 65 percent of the dollars were deposited by next business day, shows that 90 percent of the dollars were not processed until up to seven days after receipt, and significantly longer for the remaining 10 percent. This could indicate that insufficient resources were devoted to processing deposits at this peak period of the taxation year. This translates into interest of \$285,000 lost to the government on amounts in April that were left undeposited beyond the next business day, adjusted to reflect a 90 percent standard of performance. For the remaining 10 percent, interest lost was significantly higher — \$362,000 because of excessive time lags in depositing cash at the bank. The total interest cost to the government for failing to deposit all receipts by next business day for the month of April was therefore \$647,000.

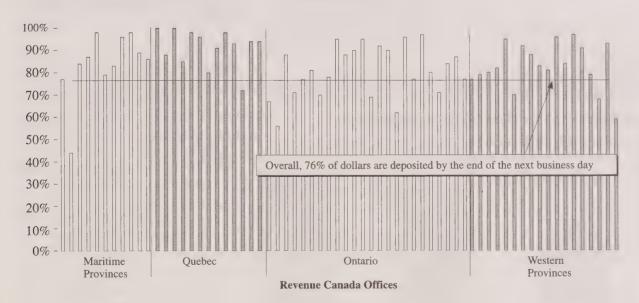
Similarly, for the month of August, the imputed lost interest due to slow processing of deposits amounted to \$43,000 on 90 percent of the receipts and \$131,000 on the remaining 10 percent, for a total of \$174,000. Even in October, when the overall performance met the minimum standard of 90 percent deposited by the next business day, the interest forgone on the remaining 10 percent by

Exhibit 31.5

#### Taxation/GST Revenue Received at Revenue Canada Offices (Excluding Customs Offices) - Processing Time over a Three-Month Period



#### **Next Business Day**



Source: Analysis of Departmental Records – Average of April, August and October 1996.

failing to deposit by next business day amounted to \$127,000. Combined, as shown in Exhibit 31.6, the total interest lost to the government by failing to meet next-business-day deposit on all receipts at Tax Centres and Tax Services Offices for the three months covered in our test amounted to \$948,000, using the average 3 percent interest rate in effect for 1996–97 between the Receiver General and the direct-clearing financial institutions.

31.36 Revenue Canada should establish, by line of business, clearer standards for acceptable time frames for deposit of remittances including clear targets for same-day deposit of receipts. It should monitor departmental adherence to those standards, and ensure that adequate resources are deployed during peak periods to support principles of sound cash management.

Department's response: Revenue Canada considers the prompt deposit of all remittances to be very important, and, to that end, has published time frames in all

procedures manuals for staff. The monitoring of departmental adherence to these standards is performed at both the regional and local office levels.

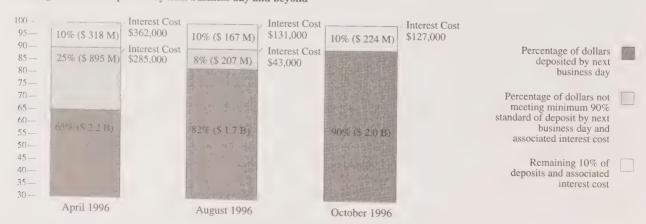
In addition, in February of 1995, a team was put together to look at the entire payment process system in Revenue Canada, and to re-engineer it using the latest technology. This includes scanning and imaging to replace manual keying operations. We are in the process of developing a new Payment Processing System (PPS) to replace most of the current payment processing systems in the Department. All of these technological improvements will improve the level of performance. Phase 1 of the new Payment Processing System is scheduled for implementation in 1998.

Although additional resources are added during the peak period of the taxation year, there are some fundamental, costly restrictions such as space and equipment that make the management of peak workloads challenging. We are, however, looking at new ways of payment processing such as automated payment machines, which should help alleviate the workload peaks.

Exhibit 31.6

Interest Cost for Delays in Deposit of Tax and GST Remittances at Revenue Canada Offices (Excluding Customs Offices)

#### Percentage of dollars deposited by next business day and beyond



Source: Departmental records and Office of the Auditor General tabulations

# Better systems needed to process excise remittances and deposits by Customs

31.37 Although we found that all amounts selected for our testing had been deposited in the bank, the deposit system used at Customs does not efficiently support the \$18 billion in cash receipts processed annually. Over \$14 billion of the receipts by Customs pertain to GST paid on imported goods. Individual offices have implemented manual forms and procedures to bridge shortcomings in an archaic national deposit system, which is largely manual. The labour-intensive nature of the Customs system raises serious questions about the cost-effective use of resources — resources that might otherwise be used to improve performance in remitting deposits promptly in the bank. Given the billions of dollars involved and the inefficiency of the manual process, the need for changes in supporting systems and practices seems evident. Subsequent to our audit, the Department informed us that changes to these systems would be considered as part of its re-engineering efforts.

31.38 Another example of inefficiency is the lack of transfer accounts that would allow financial institutions to transfer excise payments directly to the Receiver General. Banks must accumulate the total remittances they receive and forward a cheque to a Revenue Canada office for redeposit. As illustrated in Exhibit 31.3, about \$1.1 billion of excise payments are remitted at banks. A manual system is then used by Revenue Canada to track interest to be charged to the banks for the period between the date taxpayers remit at the bank and the date the banks provide a cheque to the Department for redeposit. This system is not efficient because it is highly manual and duplicates effort. The Department has informed us that changes

to eliminate the inefficiency are planned for the fall of 1997.

31.39 Revenue Canada should update Customs' systems to provide staff with a complete and effective set of tools for processing its large amounts of cash receipts.

Department's response: Revenue Canada recognizes this concern and is committed to rebuilding the current Customs system as part of its five-year plan to re-engineer all its business processes. Specifically, the Department plans to move the Customs processes to the new standardized accounting system in the year 2002. The timetable for this re-engineering is based on an analysis of the requirements of all business systems.

At this time, it would not be cost-effective or practical to effect these changes independently, as the time frames for system development would take two to three years. This would then be redundant a short time later with the implementation of a single or standard accounting system. During the intervening period, a number of interim measures are being implemented to manage payment remittance until the new accounting system is fully implemented.

# Revenue Canada's performance in revenue reporting needs improvement

**31.40** Revenue reporting. Revenue Canada needs to update its systems and practices to efficiently support the financial information reporting requirements of the Government of Canada.

31.41 While the Department is coming closer to meeting the timetable set by the Receiver General for year-end reporting, the Department of Finance has continuing concerns about the timing of the release of Revenue Canada's final figures. It believes that Revenue Canada should have these available much sooner than the usual

The Customs deposit system is an archaic and labour-intensive system that does not efficiently support the \$18 billion in cash receipts processed annually.

The Department of
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the release of Revenue
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Timeliness and reliability of revenue reports are critical issues for monitoring the performance of tax and fiscal policy measures and ensuring the credibility of financial reporting.

The key problem is that many systems that support the reporting of revenues are very inefficient, disconnected and cumbersome.

two and a half months following the fiscal year-end that the Receiver General timetable provides. In addition, Finance has noted problems with the lack of information available in the form of analyses or other volumetric information that would provide additional comfort on the revenue numbers supplied for release in the monthly *The Fiscal Monitor* and/or the annual Public Accounts of Canada.

31.42 Timeliness and reliability of revenue reports are critical issues for monitoring the performance of tax and fiscal policy measures and ensuring the credibility of government financial reporting. Finance indicated that it cannot analyze actual results until three months after the year-end because of significant variations between preliminary year-end and final figures for overall revenues being reported. Moreover, published interim financial information on revenues collected has had to be restated in the past. In particular, material misstatements between net personal income taxes and net corporate taxes had to be corrected in 1994-95, spanning several months. Similarly, during that same period, separate concerns about the quality of previously reported excise revenue numbers also resulted in restatements in The Fiscal Monitor. These errors could have been either detected earlier or prevented had Revenue Canada been reconciling its operational records to the federal government's books on a timely basis. In addition, Revenue Canada could have exercised more rigour in analyzing the reasonableness of the distribution of the monthly revenue amounts reported externally for the various taxes.

31.43 Since 1994–95 there have been no other restatements in the revenue amounts published in *The Fiscal Monitor*. Over the past few years, the Department has been devoting increased attention to

revenue reporting matters, and there have been some notable improvements evident in the revenue reporting processes and practices. In addition, over the next five years, a number of initiatives are under way to re-engineer the Department's accounting and related processes, at an estimated cost of over \$100 million. Notwithstanding the Department's improvements in revenue reporting matters and the re-engineering projects under way, in our view much more is still needed to ensure timely and accurate revenue reports by stream of revenue.

**31.44** Our analysis of Revenue Canada's performance indicates four areas of weakness that continue to impact on revenue reporting. They pertain to:

- · systems;
- standards of performance;
- reconciliations; and
- analyses.

Systems. Revenue Canada's key problem is that many of the existing systems that support the reporting of revenues in the central accounts of the federal government are very inefficient, disconnected and cumbersome. Finance and Administration at headquarters relies on program branches to process details for tax deposits, remittances, and other revenue transactions such as refunds and credits. It takes significant resources and efforts by the Department's Finance and Administration revenue reporting section to draw information from the many feeder systems and to account for the completeness of information associated with tax deposits and other transactions. The process is slow, archaic and highly labour-intensive; it also makes fundamental bookkeeping activities, such as reconciliations, difficult to perform. The risks to proper financial reporting are obvious. In addition to the systems

upgrades envisaged as part of re-engineering, more automated tools and systems are clearly and urgently needed. Among others, these would include automated matching of revenues reported in departmental systems to deposits recorded in the government's central accounts; at present, this process is largely done manually. And, as discussed in paragraph 31.37, they would also include automation of the manual systems that provide the input into feeder systems.

31.46 Revenue Canada has indicated that one of the objectives of re-engineering is to remove several of the inefficiencies of the current systems. For example, it is intended to integrate client account information with information for assessing and for revenue reporting, thereby eliminating much of the disconnectivity that now exists. The anticipated features of the new systems also include an integrated general ledger, something that the current system does not have, and something that is fundamentally important for revenue reporting purposes. The re-engineering is also intended to efficiently support accounting for tax revenues on an appropriate accrual basis, should the government follow through on its intention to do so.

#### 31.47 Standards of performance.

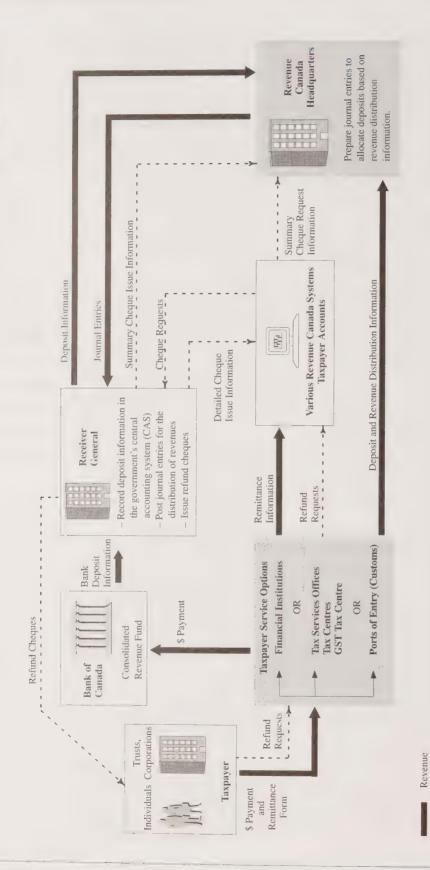
Feeder systems supporting revenue reporting practices are of varying quality; some are labour-intensive; and some are largely automated. Departmental financial manuals provide a multitude of standards for processing of transactions, largely procedural, that are geared to operations and that vary across business lines. However, they are inconsistent, incomplete or silent with respect to input controls that impact on revenue reporting, for example, to ensure the accuracy and completeness of data input, or the time frames required to clear unprocessed

inventory or to follow-up on outstanding items. While there will always be some tax dollars subject to allocation on the basis of formula or other proxy measure because of inherent time lags in the revenue reporting process — for example, between the time of deposits at banks and the time the information reaches Revenue Canada for processing — these need not be exacerbated by inefficiencies in departmental systems and practices. Of particular concern to us is the Customs system for processing deposits. As noted in paragraph 31.37, the Customs accounting system for deposits is a labour-intensive manual system. It is slow and prone to error. This system handles about \$18 billion in receipts yearly, the bulk of which is GST on imported goods. In recent years, much of the delay in finalizing year-end revenue numbers has been related to reconciling or correcting errors in the Customs accounting system.

Reconciliations. Reconciliations 31.48 are detection controls that, if done appropriately and on a timely basis, will catch errors, omissions and misallocations in recorded amounts and flag them for the attention of management to take corrective measures. Conceptually, the process is not unlike reconciling one's own bank statements each month-end. It means ensuring that all deposits are recorded by the bank in the right amounts, that all cheques and charges are appropriately processed and authorized and that one's own records of receipts and disbursements are complete and correspond accurately to those of the bank. It also means identifying any outstanding items and ensuring that they are accounted for in the monthly bank statements that follow, and that any errors are corrected on a timely basis. In our opinion, Revenue Canada does not perform all of the reconciliations that are needed for good financial management.

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Exhibit 31.7
Revenue Canada – Overview of Payment Deposit and Refund Cheque Issue Process



Source: Interviews with Department officials and examination of related systems

Refund

Over the years, we have highlighted the need for the Department to ensure that appropriate reconciliations are performed regularly and on a timely basis, to minimize errors in financial reporting and to derive assurance that systems and controls over receipts, disbursements and record keeping are functioning as they should. Exhibit 31.7 provides an overview of the deposit and cheque issue process that impacts on the Department's reconciliation process.

31.49 Revenue Canada performs a number of matching processes and reconciliations to support the control, accounting and reporting of revenues and refunds. Nevertheless, two matters in particular cause us concern. The first deals with the completeness and timeliness of reconciling revenues received, and any offsetting payments and adjustments such as refunds and transfers, to amounts recorded in the central accounts — the government's official books of account for subsequent reporting in The Fiscal Monitor and year-end financial statements. While significant improvements have been made in the quality and timeliness of the reconciliation process, we found that Revenue Canada has yet to fully reconcile all revenues, offsetting payments and adjustments to amounts in the central accounts on a regular and timely basis, and it attempts to fully reconcile only once during the year, typically at year-end.

31.50 The unreconciled amounts are significant both individually and in total. For example, while the Department advises that established policy is to have a number of checks and balances done locally to control the issuance of manual refund cheques, it does not do, at headquarters, a central reconciliation of all manually issued refund cheques; in 1996–97, \$1.6 billion of manually issued

refund cheques were not reconciled to departmental records for year-end reporting. Nor does the Department fully reconcile deposits in the government's bank account to its own records of deposits in departmental systems. Again using 1996-97 as an example, three months after the year-end the Department reported to us that out of a yearly total of over \$200 billion in receipts, there was still \$34 million in bank deposits unmatched to deposits recorded in its systems and \$28 million in recorded deposits unmatched to bank deposits, for a potential net discrepancy of \$6 million. In previous years, the unreconciled differences for cash deposits at year-end were substantially higher. Regarding the matching of deposits, the Department's position is that timing differences between the receipt of deposit information and the reporting of related information in departmental systems - is one of the major reasons it cannot reconcile fully even three months after year-end. It also states that reconciling all but a small percentage of revenues is sufficient. But a small percent on this one reconciliation alone amounts to tens of millions of dollars in unreconciled amounts. Moreover, we do not consider reasonable the Department's explanation for untimely and incomplete reconciling of amounts, for two reasons. First, the over \$200 billion in cash receipts for the year comprises only about 100,000 deposits, or an average of some 400 deposits each working day. Second, as noted in paragraph 31.37, much of the delay is due to inefficiencies in current systems, and in particular the Customs system, which accounts for \$18 billion in yearly tax receipts.

31.51 The foregoing provides two examples of a number of components missing from the Department's current reconciliation practices. The lack of a full

The lack of full and timely reconciliations means that Revenue Canada is not in a position to provide complete assurance on the accuracy and completeness of the revenue amounts for monthly and year-end external reporting.

monthly unmatched amounts get allocated among the various revenue streams using as a proxy measure a formula based on historic data. These amounts are not completely cleared up even after year-end. To the extent that the proxy measures are not in line with actual amounts, there will be inaccuracies in reporting throughout the year. In addition, these practices impact on trend analysis and on the credibility of the government's control over its finances. Moreover, the lack of full and timely reconciliation means that Revenue Canada is not in a position to provide complete assurance on the accuracy and completeness of the amounts by revenue stream for monthly and year-end external reporting, notwithstanding that it may have a strong sense of comfort that the revenues are reasonably well represented. 31.52 The other matter of concern to us

reconciliation has implications for

monthly reporting of revenues by stream,

since hundreds of millions of dollars in

Reconciling to taxpayer records would provide the ultimate check that cash and revenues reported are complete and appropriately represented by revenue stream.

is that the Department does not reconcile central account balances to its taxpayer records. The possibility therefore exists that certain adjustments, transfers, or cash transactions are not reflected appropriately in the revenue figures it reports. The importance of reconciling to taxpayer records is further highlighted by the fact that Finance and Administration does not have access to all adjustments that impact on revenue reporting. For example, the Department's taxpayer accounting systems automatically offset a taxpayer's credit balance with any liability balance for the same taxpayer. But the systems do not generate a summary listing to capture those transfers. Depending on the magnitude of these offsets, or other adjustments, this could impede the analysis of trends and variances in revenue amounts reported from one year

to the next. Reconciling to taxpaver records provides the ultimate check that cash and revenues reported are complete and appropriately represented by revenue stream. From the perspective of financial control, reconciling taxpayer records to the assessing, collection and write-off systems would also provide assurance that these systems are operating as intended for example, that all cash or remittance payments have been deposited or that no records of receivables have been lost. As noted, the Department is in the process of re-engineering its accounting systems over the next five years. In view of the importance of these reconciliations, it is essential for the Department to ensure that appropriate linkages to taxpayer accounts are designed into the new systems, that these are adequately tested before implementation, and that the reconciliation feature is instituted in tandem with each system release.

31.53 Revenue Canada should review its policies and ensure that appropriate, consistent and complete standards of performance are in place for revenue reporting across program branches, and should monitor adherence to those standards. It should ensure that headquarters is provided with more automated tools in support of revenue reporting activities and periodic and full reconciliations of revenue. As part of the re-engineering of accounting systems, the Department should ensure that reconciliations to taxpayer records are properly designed and instituted.

Department's response: Revenue Canada understands that this recommendation is based on the Auditor General's view that there are certain weaknesses in systems, standards of performance and reconciliations. The following addresses each of the three areas:

Standards of Performance: The Auditor General notes that much of the delay in finalizing year-end numbers has been related to reconciling or correcting errors in the Customs' accounting system. While Revenue Canada has made every effort to consistently meet the Receiver General timetable for completion of the final financial statements, the need to undertake work on the deposit processing systems in Customs' programs is recognized. Interim solutions to address the shortcomings are being examined, while longer-term solutions will be identified as part of the overall re-engineering initiative. The Department will continue to ensure the completeness and accuracy of revenue information for each accounting period and communicate such information to the Department of Finance as expeditiously as possible, as was the case for 1996-97.

Systems: Revenue Canada has recognized that some inefficiencies exist in current systems and these are being addressed as part of a major re-engineering initiative currently under way in the Department.

Reconciliations: The two examples of weaknesses in reconciliations relate to manually issued cheques and the matching of deposits to departmental records.

Procedures exist for local offices to control the issuance of manual refund cheques. These procedures are supplemented by central reconciliation at headquarters for the majority of manually issued cheques. The procedure for central reconciliation for the remainder will be established in 1997-98.

With respect to deposits, at the time final financial statements were prepared, Revenue Canada had matched all but \$6 million out of the more than \$200 billion deposited during the year. This unmatched amount has since been reduced to just over \$2 million by the ongoing matching process and is expected to be further reduced as regional offices continue to provide supplemental

confirming data. It should be noted that the majority of unmatched deposits are generally the result of unrecorded foreign exchange and keying errors. The Department is examining systems improvements that will minimize such occurrences.

As part of the current re-engineering initiative, new interfaces to all existing revenue lines, with appropriate financial and systems controls, are being built and tested. Accordingly, links from all assessing and post-assessing transactions to the new Revenue Ledger will provide assurances that information is correctly passed from one system to another, thereby facilitating the reconciliation processes.

Analysis. Although recognizing that improvements have been made over the past two years, the Department of Finance has informed us that more analyses and more timely analyses are needed from Revenue Canada to ensure the reasonableness of month-end and year-end revenue numbers provided for external reporting, and to indicate relevant factors that explain period-to-period fluctuations under the current cash basis of accounting. For example, it expects Revenue Canada to be in a position to assess the impact of administrative, technical, and remittance regulations on the monthly and year-end revenue reports on a proactive basis — prior to the release of these figures. This would include, for example, knowing the impact of delays in batch entries, unprocessed claims, returns and refunds, and of changes in remittance and refund patterns for key taxpayers.

31.55 Revenue Canada informed us that both Finance and Administration and program branches have responsibility for analyzing the reasonableness of revenue reports under the cash basis of accounting. Finance and Administration at headquarters has a more limited role in this area, since revenue details are found in the feeder systems. In our discussions

Program branches react mostly to queries from headquarters or the Department of Finance rather than proactively seeking to assure themselves of the reasonableness of revenue reports prior to their release.

The Department of Finance would like Revenue Canada to do more independent analysis of revenue fluctuations.

with program branches, it was not evident that there were any standards in place pertaining to the nature of routine analyses to be performed and the frequency of such analyses, or to the kind of information that would need to be considered, as a minimum, when analyzing the reasonableness of period-to-period revenue numbers for financial reporting purposes. We also found that program branches are not provided with any parameters on what constitutes significant period-to-period fluctuations requiring prompt investigative action. For the most part, program branches react to queries from headquarters or the Department of Finance, usually following the release of revenue figures, rather than proactively seeking out information to assure themselves of the reasonableness of revenue reports from period to period prior to their release. In this regard, we believe the Department could routinely analyze some key volumetric information that under a cash basis of accounting would result in a better understanding of the reasonableness of revenue fluctuations. For example, large taxpayers not filing remittances on time could account for big swings in period-to-period amounts reported for some revenue lines. and these could be identified regularly before the release of interim revenue reports. We note that Finance and Administration at headquarters is looking at doing more revenue analysis.

31.56 Along with the lack of specific departmental guidance from Revenue Canada on analyses in support of revenues being reported, we also noted that the Department of Finance does not provide Revenue Canada with any criteria on the degree of accuracy required by revenue stream for reporting in *The Fiscal Monitor* and in the Public Accounts. While terms of reference between Finance and Revenue Canada do exist for revenue

reporting matters, they are expressed in broad terms, focussing on roles and responsibilities, and are void of any specific guidance on what would constitute a significant distortion in each revenue stream. Nor is there any communication of assumptions implicit in revenue forecasts. This is information that could assist Revenue Canada in dealing with interim or year-end reporting issues. It would also provide a better context to assess period-to period revenue reports for reasonableness and potential distortions.

As part of our audit, we considered queries about revenue fluctuations raised by Finance for follow-up by Revenue Canada. We found that most queries related to specific bookkeeping issues, some of which were addressed on a more timely basis than others. However, in one particular case. after considerable delay and despite a number of requests from Finance for volumetric information on the stock of unprocessed GST credit claims each reporting period, Revenue Canada is only now beginning to address the issue. It did not respond earlier because one of the key program branches responsible for this information gave it a lower level of attention.

31.58 The issue of GST fluctuations is an important one for financial reporting purposes. As shown in Exhibit 31.8, the monthly revenues have fluctuated significantly over time and with no apparent pattern. In addition, GST revenue for 1995-96 unexpectedly decreased by \$400 million from 1994-95. We feel that Revenue Canada and Finance together ought to be able to understand and explain such fluctuations, which may be the result of many factors (the volume in unprocessed GST credit returns and GST claims at the end of a reporting period may be one factor). Chapter 32 of

this Report focusses on the two departments' analysis of the \$400 million decrease and recommends ways in which the departments' analytic capability could be strengthened.

31.59 Over the past two years, an interdepartmental Fiscal Monitor Committee with representatives from both Revenue Canada and Finance has been established to help deal with reporting issues. Since the fall of 1996, the meetings have been more structured and formalized. According to both Revenue Canada and Finance, they are providing a good forum for dealing with issues and for understanding respective needs and constraints. It is largely through this forum that questions on revenue fluctuations get raised by Finance for Revenue Canada's analysis or follow-up. Nevertheless, Finance would like Revenue Canada to do more independent analysis and, in

GST 1994-95

GST 1995-96

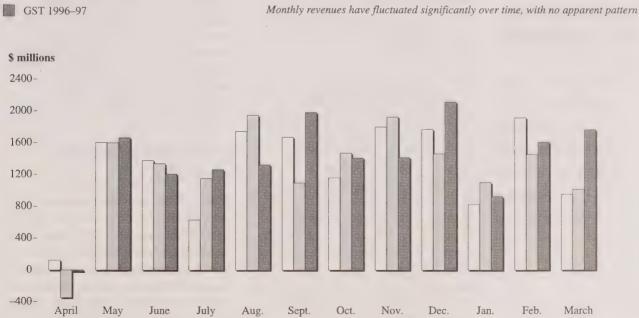
response to queries raised, more timely analyses.

Revenue Canada should clarify 31.60 its expectations of program branches for analyses relating to the monthly revenue reports, and provide criteria for thresholds that would prompt investigative action.

**Department's response:** As noted by the Auditor General, the interdepartmental Fiscal Monitor Committee is providing a good forum for dealing with analysis issues. However, it is often difficult to identify thresholds that would prompt investigative action, since there are many reasons why a variance might occur. The installation of thresholds would not, in all cases, identify instances where investigative action is called for. However, Revenue Canada, in concert with the Department of Finance, will continue to develop specific performance measures

Exhibit 31.8

GST Monthly Revenues for 1994-95, 1995-96 and 1996-97



Source: The Fiscal Monitor, Table 2, Department of Finance, April 1994 - March 1997

that prompt investigative action and report on them regularly.

31.61 For revenue reporting matters, the Department of Finance should specify required levels of precision by stream of revenue, and equip Revenue Canada with information on economic assumptions implicit in revenue forecasts.

Department of Finance's response: The Department of Finance will continue to work closely with Revenue Canada in the analysis of monthly tax collections.

# Excluding revenue reporting, stakeholder information needs are largely met

31.62 Beyond revenue reporting,
Revenue Canada is relied upon to provide
accurate, reliable and timely information
to many stakeholders. We wanted to see if
other major stakeholders' needs were
being met. We considered the Tax Policy
Branch within the Department of Finance,
some areas of Trade Statistics, Business
Sectors and socio-economic areas in
Statistics Canada, and the Treasury and
Accounting section of the Receiver
General of Canada.

31.63 The Tax Policy Branch needs accurate and complete information on revenue programs to assess the workings of the current taxation system and to be able to determine the possible impact of future tax measures. We found that, generally, the reliability of the data meets the needs of the Branch. However, there are issues still to be resolved concerning the timeliness, sufficiency and availability of certain revenue data. Both departments have discussed these issues, some temporary measures are being worked out, and a memorandum of understanding (MOU) may be negotiated on these matters. A separate interdepartmental

committee representing both Finance and Revenue Canada has been established to deal with tax policy matters and issues. Meetings of this committee provide another good forum for dealing with respective needs and constraints.

31.64 Revenue Canada provides Statistics Canada with information on individual and corporate taxpayers, trade of goods, and traveller entry. Revenue Canada has negotiated a number of MOUs with Statistics Canada to facilitate the transfer of data, clarify terms of reference and ensure that confidentiality provisions are upheld. Officials from the major program areas at Statistics Canada who receive information told us that they are generally satisfied with the timeliness and quality of the data and have maintained frequent contact with Revenue Canada liaison personnel.

31.65 The Receiver General provides the banking facilities to support the deposit function and manages the reporting of Revenue Canada's departmental financial figures. Receiver General officials noted that Revenue Canada's monthly accounting for its cash deposits often extended several days beyond the deadlines established for each month-end. Overall, officials noted improvements in the timeliness of accounting for cash deposits in the last three years.

#### **Key Central Administrative Functions**

31.66 In addition to looking at the Department's performance in two key areas of fiduciary responsibility, we examined the central administrative functions that underpin any financial management regime aimed at ensuring the orderly, efficient and effective conduct of business affairs, namely: planning, funding, budgeting, performance

A separate committee representing both Finance and Revenue Canada has been established to deal with information needs for tax policy matters.

monitoring, reporting, and holding managers to account for results achieved.

## Department-wide, planning processes are sound and still evolving

31.67 We looked at the Department's strategic and current-year planning at both the corporate and the operational levels. We assessed the way the Department defines its long-term and short-term plans and commitments and the way it makes these commitments known in the field. We also examined the processes designed to hold managers to account. Our focus for much of the planning work was on the Department's Business Plans.

31.68 For the period under review, Revenue Canada has been proactive in formalizing its corporate strategies and directions for the future, encouraging more regional participation in the planning process and communicating plans and intentions to the field.

In keeping with its strategic objectives, the Department has held regular planning and priority-setting meetings, both at the corporate level among senior management and between program branch managers and regional operations in each of the Department's lines of business. These initiatives were said to have resulted in a better understanding of the priorities and constraints facing the Department and of the deliverables expected from operations. Recently, the Department reorganized its senior management committee structure to further promote the sharing of key management concepts and best practices in its diverse mandate, and to identify ways of better ensuring a horizontal and co-ordinated approach to managing overall operations.

## Plans reflect government objectives and priorities

31.70 We reviewed the 1995–96 and 1996–97 Business Plans against the 1996–97 Part III Estimates and the federal Budgets for the last five years, and against the Department's Outlook, Planning and Update documents and Performance Reports that it tabled in Parliament in 1996–97.

31.71 The results of our review were generally positive. We found that the documents appropriately reflected the government's priorities and the challenges facing the Department. We also found that the Updates and the Performance Reports were generally linked to the Outlook and Planning documents.

Program branches have begun to 31.72 develop their own strategic and current-year plans from the corporate plans. Current-year plans include budget, resource and workload considerations. In addition, management contracts are emerging that further devolve responsibility and accountability to the field, reflect branch objectives and priorities, and are meant to strengthen managers' accountability. Although they are evolving, and are at different levels of refinement among business lines, generally the agreements communicate priorities and responsibilities for managers and define expectations for deliverables more specifically, either qualitatively or quantitatively — in the latter case, mostly in the form of information to be collected on a wide range of volumetrics or outputs (for example, number of seizures at borders, number of returns processed). We also noted a few measures expressed in terms of outcomes or emerging target outcomes. For example, we observed targets for the collection of tax debts.

**31.73** We acknowledge that tracking outputs is important for an organization

Revenue Canada has been proactive in formalizing its corporate strategies and directions for the future.

Management contracts are emerging that further devolve responsibility and accountability to the field, reflect branch objectives and priorities, and are meant to strengthen managers' accountability.

Customs has recently established several outcome and output targets for its
Travellers Program.

such as Revenue Canada; they provide some measure of productivity. In our view, outputs and targets taken together in the context of outcomes to be achieved would constitute more appropriate results-oriented deliverables against which to assess actual performance. The initiatives taken in this area by some programs are encouraging. Chapter 11 of our October 1997 Report presents one such initiative by Customs for its Travellers Program. Customs has recently established several outcome targets such as those for traveller compliance by region, together with output targets for the number of inspections to be conducted. The outcome targets are expressed as the expected percentage of travellers at ports of entry who voluntarily comply with laws for entry into Canada. Customs has also taken steps to measure and report on actual performance against planned target outcomes.

31.74 In addition to defining more results-oriented deliverables, for planning it is important to also establish target costs for the results expected, and to ensure that the results are, in fact, measured and costed. During our audit we found that for many aspects of management contracts, actual costs for each specific deliverable would be difficult to determine. The focus of much of our review was on management agreements covering the 1996–97 fiscal year. We did not review the extent to which performance against deliverables was measured, since this information as well was not readily available. As noted, management contracts are still evolving. On the whole, we support these initiatives - not only because they begin the process to clarify performance expectations but also because the attendant reviews and discussions help to establish a common vision. However, we think more emphasis needs to be placed on cost considerations.

31.75 The Department should expand the use of management contracts and ensure that they provide targets for deliverables in measurable terms together with expected costs to achieve them. Monitoring of performance against plans and cost targets should be enhanced and the results used to hold managers to account.

Department's response: The Department recognizes the benefit of management contracts to establish performance expectations and lines of accountability. Indeed, management contracts have been in use in a variety of forms, in various headquarters program areas for several years. In 1996-97, contracts were expanded to headquarters functional authorities and the regions. Customs, for example, makes effective use of headquarters-regional accountability contracts to establish targets and monitor performance. The contracts set out clearly the program objectives, program delivery expectations and the allocation of resources to achieve results.

The contracts constitute a key component of the Department's overall accountability regime and also serve as a reference point for both program and corporate reporting. The use of such contracts is evolving and managers are encouraged to include in the contracts targets for deliverables in measurable and meaningful terms and link these to costs.

The various levels of accountability resulting from these contracts are reflected and tracked through the Department's management monitoring and reporting systems for both internal and external use. For example, at the business line level, the Department includes program accountabilities and results commitments in the Report on Plans and Priorities (Part III of the Estimates) and provides actual results in its Fall Performance Report. Considerable progress has been made in this regard.

Revenue Canada remains committed to expanding the use of management contracts and related accountability mechanisms and to monitoring performance against them.

## Department's annual funding cut by \$300 million

- 31.76 Government restraint initiatives have resulted in significant multi-year cuts to the Department's annual resource levels for regular workload. In total, by 1998–99 these will amount to \$300 million annually, representing a reduction of 14 percent from 1994–95, to continue indefinitely thereafter (see Exhibit 31.9).
- 31.77 The Department used its 1995–96 and 1996–97 Business Plans to alert decision makers to the potential impact that further cuts would have on its ability to maintain the integrity of its programs, and provided its strategy for managing with declining resource levels. Its strategy, as it had also outlined to the Standing Committee on Finance, was:
- to concentrate reductions in administrative and program support areas;
- to offset reductions with savings expected from the administrative consolidation of the two former revenue departments and a wide range of business process re-engineering initiatives; and
- to request resources from the Treasury Board for any new work (for example, new government priorities, tax policy initiatives, volume growth).
- 31.78 Underpinning this strategy was a judgment call on the minimum level of resources needed to maintain the integrity of programs, taking into account the benefits expected from initiatives, which were also based on value judgments. Revenue Canada also made a commitment to constantly monitor the funding situation

and advise the government and Parliament accordingly.

- 31.79 The Department informed us that in keeping with its strategy, it has assigned the majority of its cuts to administrative and program support areas, as well as to more process-oriented activities where it thought the benefits of re-engineering initiatives and the application of technology would be maximized.
- 31.80 In June 1996, senior management established a Project Review Committee that was tasked to assign re-engineering project priorities and oversee their progress to implementation. A central fund of \$83 million over three years, subsequently increased to \$128 million, was established to help program branches defray their associated costs. Before June 1996, key re-engineering projects were reviewed centrally for decisions on funding but were not subject to any independent, systematic monitoring or scrutiny before implementation.
- 31.81 We were interested in knowing which of the Department's wide range of business process re-engineering initiatives were critical to offset the effects of funding costs in the future, and how the related actual benefits/savings were being tracked and the effects monitored Department-wide. We were also interested in how the Department assured itself of "not compromising program integrity" across the business lines in this period of declining resources.
- 31.82 The Department indicated that many of the expected savings from key re-engineering efforts will begin to materialize only in future years. It notes that the cumulative impact of the cuts, combined with other changes affecting the Department's budget or program priorities, is under continuous review by senior management through a number of forums where funding issues can be

The Department's
Business Plans alerted
decision makers to the
potential impact that
further cuts would
have on its ability to
maintain the integrity
of its programs.

Revenue Canada uses business cases to support its requests to Treasury Board for approval of additional funding.

More rigorous quantitative challenge of business cases is needed, as well as a system to monitor the use of funds and associated results received for specific purposes.

raised, including the Project Review
Committee, the Priorities Committee and
the full Departmental Management
Committee. It further states that most
funding issues are dealt with internally
and, where absolutely necessary, referred
to the Treasury Board. We encourage the
Department to maintain its effort to ensure
that reductions are achieved in the
targeted areas and do not compromise the
integrity of essential programs.

31.83 External funding. Revenue Canada uses business cases to support its requests to Treasury Board for approval of additional funding for new work, which includes volume growth or new projects. In 1995-96 and 1996-97, the Department's additional funding requests for new work amounted to over \$1.3 billion to meet its needs until 1999–2000. It received approval for about \$970 million; some of these approvals were added to the base level to continue indefinitely. Exhibits 31.9 and 31.10 provide additional contextual information on the amounts requested and approved for the five years, using the 1994-95 funding levels as the reference point. In particular, they show that prior to Program Review reductions, Revenue Canada would have been allocated some \$11 billion to fund regular workload during the five-year period, but subsequently had to absorb about \$1 billion in spending reductions from that level. Over the same period it received a total of about \$1.4 billion for new work: the \$970 million referred to above in approved business case submissions, and a further \$430 million for adjustments needed to account for such things as programs transferred to Revenue Canada from other government departments. All business cases are initially prepared by program branches and then are reviewed by Finance and Administration at headquarters, for objective challenge by

an analyst. Once through this process and approved, the business cases are sent to the Deputy Minister for recommendation and ministerial approval and then submitted to the Treasury Board.

31.84 Business cases are integral to the Department's process for obtaining funding for new work. We reviewed 30 business cases, out of a total of 52 covering the 1996 and 1997 fiscal years. We selected eight for detailed examination.

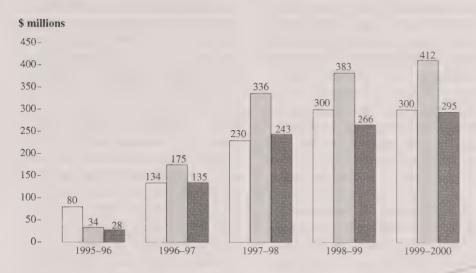
31.85 We found that all the cases we reviewed were qualitatively sound, in that they included, for example, background information, the justification for the request, and the projected impact if the resources were not secured. Some of the cases relied on regression analysis to predict growth patterns, while others used weighted averages; the approach depended on the nature of the operation being costed. We found the approaches used to be generally appropriate. In the cases that had multi-year funding implications, we noted that the assumptions forming the basis of the multi-year estimates were consistent from year to year. We are generally satisfied with the supporting documentation used and the challenge offered by the analysts, except as noted in the following paragraphs. In particular, we found that more rigorous quantitative challenge of business cases is needed as well as a system to monitor the use of funds and associated results received for specific purposes.

31.86 Accounting for specific-purpose funds. Revenue Canada devotes considerable effort to preparing business plans in support of additional funding for new work. Once the funds are received they are rolled into the Department's overall budget. Unless required by the Treasury Board, it does not track

Exhibit 31.9

Five-Year Spending Cuts Compared with Requests and Approvals for Additional Funding for New Work

(Using 1994–95 as the Reference Point)



Spending Cuts (Total \$1.0 billion over 5 years)

Requested Funding for New Work (Total \$1.3 billion over 5 years)

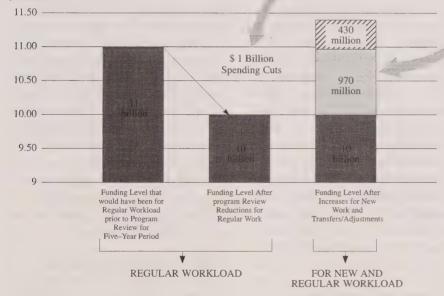
Funds Approved for New Work (Total \$970 million over 5 years)

#### Exhibit 31.10

## Five-Year Aggregate Funding Statistics from 1995–96 to 1999–2000

(Using the 1994-95 Funding Levels as the Reference Point)

#### \$ billions



Transfers and Adjustments

Funding for Regular Workload

Source: Departmental Information

The effects of re-engineering and other business process initiatives when estimating costs in funding requests need to be looked at more closely through the challenge process.

separately the use of resources and associated results made available for specific purposes. The Department's position is that while it considers it has the capacity to track both the use and associated results of specified funds, it chooses not to on grounds of cost/benefits. Moreover, it believes it has the flexibility to reallocate funds received based on emerging priorities. It also has stated that some projects or activities are more amenable to tracking than others. For example, accounting for incremental growth would be more difficult since the impacts are spread across the Department.

31.87 While we agree that some projects or activities may be easier to track and monitor than others, in our view the complexity of doing so, or the absence of specific directives from central agencies to do so, does not mean that management should not have assurance that the funds are generally being used for their intended purposes. In view of the approval that Revenue Canada has received of sizeable funding for new work or specified initiatives (as noted. cumulatively about a billion dollars in the last year and extending for the next several years), in our opinion at least some analysis at an appropriate time of the use of additional funds and results achieved against assumptions and objectives in the underlying business plans is needed for accountability purposes. Results from the analysis would then feed into the process for preparing, challenging and approving future business plans — for instance, on the reasonableness of assumptions used and associated cost considerations. This information would also serve to hold managers to account.

31.88 Need for more rigorous quantitative challenge. We found calculation errors or an absence of substantiating information in three of the

eight funding requests we reviewed in detail; in two of the cases, the combined calculation errors resulted in approval of excess funding to the Department of \$700,000 – \$164,000 of which extends annually for an indefinite period. In the third case, a portion of the requested resources, amounting to \$1 million (also for an indefinite period), was inadequately substantiated.

31.89 The Department has not been consistent in accounting for the effects of re-engineering or other efficiencies on anticipated costs of new initiatives. For example, another case we reviewed involved a request for \$59 million over three years to handle projected increases in the volume of individual and corporate tax returns and payment processing. The Department used existing productivity rates to calculate the amount requested, but did not consider the anticipated increased efficiency and therefore the lower costs expected from the introduction of automated scanning technology. By contrast, in another case, in estimating the resources required to deal with GST registrants who do not file their returns, the Department factored in the savings that would flow from a re-engineered collection process. In so doing, it improved the accuracy of its cost estimate and reduced its funding request by more than \$4 million (17 percent of the amount requested). The need to consider and scrutinize the effects of re-engineering and other business process initiatives when estimating costs in funding requests is obvious. These need to be looked at more closely through the challenge process.

31.90 The Department should consider the effects of re-engineering and other business process initiatives in estimating costs, to support funding requests to the Treasury Board.

Revenue Canada should subject

business cases to more quantitative objective challenge. It should, at an appropriate time, analyze the use of funds received for specific purposes, consider the information in preparing future funding requests, and hold managers to account.

Department's response: Revenue Canada agrees that the effects of re-engineering and other initiatives should be considered in estimating costs to support funding requests to the Treasury Board.

In fact, this is done on a regular and consistent basis, by the Department's financial management and accounting functions. However, this can be carried out effectively for new projects only when the anticipated benefits, including savings, have been realized or are expected to be realized.

Departmental managers at all levels of the organization are held fully accountable for the management and use of resources, and the results to be achieved. This is assured through regular monitoring at meetings of the senior Departmental Management Committee.

The Department also fully accounts for its use of resources and results achieved, through regular reporting to Parliament in its annual Report on Plans and Priorities and subsequent Performance Report.

## Deficiencies exist in budgeting and cost systems

31.91 Managers in the field reported that they understood the budget allocation process fairly well, that the annual call letter documentation was adequate and that they had an opportunity to discuss resource levels with program and regional managers and make known their views on the pressures resulting from budget cuts.

31.92 Managers enter their budget information in a centralized national budget system. Common complaints are

that this system is over 20 years old and difficult to use in reconciling total activity hours with the activity management system. It also has limited budgeting options, so some managers do not bother to enter all the details on overhead (indirect codes). Specialized reports take a long time to be produced, and the user manual is out-of-date. Our observations about the system confirm that the current design does not provide useful, relevant cost information on individual projects that cut across responsibility centres in the various lines of business, and it hampers the ability of managers to optimize the use of resources. For example, during our audit we became aware of a situation in which resource management staff, even after about two months and numerous requests across the Department, were still unable to provide overall cost-to-budget statistics on a re-engineering project that had just been completed. Similarly, the Department cannot get accurate information on actual costs in relation to budget estimates for a re-engineering project currently under way, valued at an estimated \$78 million.

As with the budgeting systems, we found that the support systems used to track production (hours and related dollars) and expenditure data were over 20 years old, were cumbersome to use, did not provide timely information and had been modified in haste to meet administrative consolidation needs. Customs and Trade Administration stated that the systems did not meet many of its needs. Similar observations were raised by many officials across the lines of business. We also observed the use of proxy measures when determining the ceiling for payment of costs associated with a particular partnership agreement. The Department has documented many of these long-standing problems in data quality and system inefficiency and is in

Budget and cost systems are 20 years old, are cumbersome to use, do not provide timely information and lack relevant cost information on individual projects that cut across responsibility centres. the process of completing specifications for the replacement of administrative support systems, but the earliest date for delivery is April 1999.

31.94 When completing the specifications for its new systems, the Department should ensure the capture of complete, timely, relevant program production and expenditure costs.

Department's response: Revenue Canada will endeavour to develop as comprehensive a set of specifications as possible for its net systems, in order to improve accessibility, timeliness, and the amount of information provided.

# Need for more outcome-oriented performance monitoring tied to corporate objectives

31.95 For the period under review, we wanted to know the extent to which program branch and regional management were fully aware of the results they were expected to achieve, the extent to which program results were linked to corporate objectives and communicated to senior management, and the extent to which program branches were appropriately tracking and reporting the cost of delivery through adequate cost support systems.

31.96 At Revenue Canada, management committees review program direction and performance. Strategic program goals and priorities are set both by the Departmental Management Committee and bilaterally by the Deputy Minister and assistant deputy ministers. Program branches bring forward performance information to the Departmental Management Committee to report on results being achieved, many in the form of operational outputs and a few in the form of outcomes achieved against pre-established target outcomes. We observed that while the Department has defined a number of strategic goals, work is needed to transform more of these goals into target outcomes and to define the appropriate measures against which to assess performance. While most performance measures are decided by the program branches, we have been informed that a number have also been set by the Departmental Management Committee and the Deputy Minister. Recently, Revenue Canada has begun using standing agendas to review program branch performance on a periodic basis. It has indicated that the Departmental Management Committee provides an effective forum for challenging reports on performance and that this process also impacts on the performance measures being used. We encourage the Department to continue its efforts in this area, and to expand its current challenge process to ensure that appropriate target outcomes and outputs are established in line with corporate objectives and strategic goals, that the indicators of performance used are the correct ones, and that they are reviewed periodically by senior management for relevancy.

31.97 We found that management at headquarters and in the regions had good knowledge of the resources made available to program branches and regional operations to deliver services, and had knowledge of the outputs they were expected to deliver. As noted earlier, some program branches have begun to provide information on target outcomes together with critical measures of success for field operations, but these were in the initial stages of development.

31.98 The Department should expand its challenge process to ensure that appropriate target outcomes and outputs are established for program and regional operations in line with corporate objectives and strategic goals, and that indicators of performance used

While the Department has defined a number of strategic goals, work is needed to transform more of these goals into target outcomes and to define the appropriate measures of performance.

are the appropriate ones. It should review these periodically to ensure that they remain relevant.

Department's response: As one of the original six pilot departments, Revenue Canada participated in the Improved Reporting to Parliament Project, by preparing revised Estimates documents focussing on planning and performance information, with a renewed emphasis on results management.

Through its continued participation in the pilot project, the Department remains committed to improving performance measurement reporting. The Department will continue to work closely with central agencies and the Department of Finance in the further development of appropriate performance indicators for all its business lines.

The Department is also active in developing service standards. Fifteen service standards for major external services such as Rulings on Technical Income Tax Law Interpretations, Enquiries Programs and Processing Services have been developed, with an additional 17 planned for completion by the end of 1997.

## Poor generation of information to support decisions

31.99 Departmental officials reported that many program systems were inefficient for decision-making purposes, since the information was "locked" in old systems not initially designed for this purpose and they often provided fragmented information. These difficulties are impediments to reporting by the program branches on the attainment of a number of program objectives. We reviewed the content of 106 items in the 1996 Performance Report and found that the information came from over 30 different systems; about 55 percent of the items had to be manually generated since

the information was not readily available in formal systems. Some of these items were tied to studies to generate specific performance information. However, others had to be manually generated because of disconnected systems, or systems not moving as fast as needed to provide the required information. We noted that many of the items were of a volumetric nature. presented without targets that would offer a context to assess performance. Some information items could not be supported. since they had been generated at a specific moment and could not be replicated. Because of the disconnectivity of systems, the information used for performance is not readily available to all, and so it is difficult to monitor overall performance nationally.

31.100 In addition, in interviews with departmental officials, many indicated that it usually takes from four to eight weeks to obtain from systems even simple ad hoc data extractions that have not been previously requested. Where the requests involve complex data manipulations and analytical information to satisfy internal user needs, the turnaround time is said to be much longer, entailing many months as opposed to weeks. We noted recurring cases where these complex requests had to be redone because of erroneous initial processing linked to definitional problems in data selection or to systems complexities. One program branch has initiated a pilot "data warehouse" project in an effort to address existing systems shortcomings, in order to allow for timely, flexible access to data needed to manage program operations effectively. However, this does not solve immediate problems, nor does it respond to needs across all business lines. This is worrisome since Revenue Canada is accelerating its shift to an information-based organization, becoming increasingly reliant on diverse

Where requests involve complex data manipulations and analytical information to satisfy internal user needs, the turnaround time is said to entail many months.

Management has not independently validated the quality of data as the systems have evolved through the years.

Management relies on proxy measures, informal information systems and other bridging practices to compensate for the shortcomings of the formal systems.

forms of information to ensure that scarce resources are deployed where risks are greatest.

31.101 Our audit revealed that the concept of system ownership was not well understood by some program managers, most of whom assumed the reliability of the data in the systems. Management has not independently validated the quality of the data as the systems have evolved through the years. Program analysts reported having to independently clean and purify the data in some systems, which was difficult and time-consuming.

31.102 The Department should ensure, and periodically review, the integrity of information in its systems.

Department's response: The Department recognizes fully the importance both of overall systems integrity and of the accuracy and reliability of the information in its systems, and conducts some reviews and assessments of the information contained in its automated systems.

For example, in the Customs program, the concept of system ownership and responsibility for the integrity of information in those systems is generally understood and accepted by program managers. Moreover, there are automated validation processes in place, complemented by monitoring procedures to ensure the ongoing operational integrity of systems and the quality of data being stored.

Similarly, within the Department's verification and enforcement function, specific program and technology support functions are dedicated to the monitoring and review of the integrity of data in custodial information systems. Data validation and error reporting are undertaken on a regular basis to monitor the accuracy and quality of data input by field staff. In addition, regular meetings of headquarters, regional and field staff are held to ensure that follow-up action is

taken where necessary and that the integrity of data is maintained.

## Financial Management Environment

31.103 The third part of our audit looked at Revenue Canada's broad approach to managing financial management organization-wide. We considered the organization and priorities of the Department and how these affect its financial management systems.

## Systems and technology are a crucial duo for Revenue Canada

31.104 Systems and technology are among the most important tools Revenue Canada has at its disposal to deliver its mandate. They underpin virtually every activity or operation the Department administers, and provide the means by which Revenue Canada can deal with tens of millions of diverse transactions each year, efficiently and at a much-reduced cost.

31.105 The results of our audit indicate overwhelmingly that many of the Department's formal systems are weak, particularly in the areas of cash management, revenue reporting, performance monitoring, containing financial risks, and ensuring that resources are used effectively and efficiently. Several of the systems are old in design, labour-intensive, slow to generate information, or very inefficient. The information they provide is typically fragmented and, in many instances, not the type of information management needs.

31.106 Management relies on proxy measures, informal information systems and other bridging practices to compensate for the shortcomings of the formal systems.

# Meeting basic legal requirements and government initiatives are top departmental priorities

31.107 The Department's top priorities are to meet legislative requirements and support government-wide initiatives. Financial management must support the Department's efforts to achieve the government's stated overall intentions and priorities and to ensure that the laws, as they affect Revenue Canada, are complied with.

31.108 Meeting these obligatory priorities year in and year out is a complex undertaking. In addition to complying with financial laws and executive authorities, Revenue Canada must also ensure that its assessing systems and delivery programs reflect any new legislative measures that impact on the collection of income tax, GST, customs or excise duties and levies, as well as any social or economic benefits administered through the tax system. Similarly, the Department must also take into account any provincial requirements that, through partnering arrangements, are administered through the federal tax system.

31.109 Departmental officials inform us that changes in requirements rooted in federal or provincial tax legislation alone typically translate into tens of thousands of programming refinements to assessing systems each year. Revenue Canada often has only very short lead times in which to institute such changes to meet statutory deadlines, even when they entail the introduction of major new programs.

31.110 The introduction of GST credits in 1990 and child tax benefits in 1993 are two good examples. From the time of the respective Budget announcements, Revenue Canada had less than a year to implement the systems and procedures to deliver the Child Tax Benefit Program,

and less than 20 months to implement the systems and procedures to support the entirely new GST and related GST credits. This placed considerable pressures not only on existing departmental systems and on the creation of new ones but also on the delivery of programs to facilitate taxpayers' compliance with new legislative requirements.

## Financial management competes with other priorities

**31.111** During our audit, senior officials indicated that meeting legislative requirements and government-wide initiatives was their first priority. The second priority was dealing with matters impacting directly on taxpayers accounts, records and benefits. Third was dealing with re-engineering initiatives to streamline business operations and make them more cost-efficient, and maximizing the benefits of administrative consolidation by integrating data for the benefit of management and taxpayers. A distant fourth, given the pressures already placed on existing systems and practices to meet ongoing commitments, was to deal with internal needs or improve the management of programs and operations. The correction of shortcomings in formal systems depends either on the Department's priorities for systems work or on the priorities established within business lines for financial management matters in general.

31.112 The Department has a generally impressive track record of developing systems to meet basic legal requirements in programs and operations that involve collection or disbursement of billions of dollars and to deliver on government-wide initiatives. As noted, these achievements represent a significant challenge and require a concerted departmental effort, often not without compromise.

Compromises have typically translated

Senior officials indicated that meeting legislative requirements and government-wide initiatives was their first priority. A distant fourth, because of other pressures, was to deal with internal needs or improve the management of programs and operations.

Five years after the launch of the new regime for processing individual tax returns, the systems and practices to contain financial risks still have significant deficiencies.

into shortcomings surrounding financial management requirements that are more discretionary.

31.113 Our audits in the Department over the past few years have noted some pertinent examples of compromises impacting on financial management in several programs. For example, in 1996 we looked at the administration of child tax benefits and GST credits, an \$8 billion-a-year operation. We concluded that while basic legal requirements were met, a number of fundamental checks and balances were lacking; as a result, financial risks could be significant. From 1993 to 1995, we looked at the regimes for collecting income tax debts and GST debts, the Department's management of the Scientific Research and Experimental Development program, the new regime for processing individual income tax returns, and the Non-filers and Special Investigations programs, among others. Those audits found several deficiencies in financial management, for example:

- ineffective risk-scoring systems to minimize revenue losses:
- problems with data integrity in management information systems maintained for certain programs;
- the reporting of insufficient or inaccurate financial management information that impacted on the management of the government's finances;
- inadequate analysis of information being generated;
- erroneous or untimely program statistics meant for monitoring purposes;
- insufficient or inadequate analysis of financial and operational results; and
- a need for better accountability and results-oriented information.

31.114 As noted in paragraph 31.16, the Department is making satisfactory progress in dealing with several of our observations. Some shortcomings remain and are starting to have a multiplier effect. Clearly, it is important that the Department maintain the momentum of ongoing corrective actions and give appropriate priority and attention to correcting remaining deficiencies.

31.115 A case in point is the new regime for processing individual tax returns. We note that five years after the launch of the new regime, systems and practices to contain financial risks still have significant deficiencies. As discussed in October 1997 Chapter 18, Revenue Canada has made strides in purifying data that are essential to analyze the trends in non-compliance of returns and the effectiveness of scoring routines to contain financial risks. However, it has done only limited analysis of these data in an effort to understand and address problems with non-compliant reporting. Several of the federal government's social programs are linked to an individual's assessment of net income for tax purposes. Errors in individual returns, therefore, also impact on entitlements to social benefits, both federal and provincial.

31.116 The potential effects on the public purse are substantial. For the 1993 tax year, for example, using the results of its random samples on 16 deduction or credit line items, the Department estimated that the total net tax recoverable for the entire population of returns would amount to \$181 million. Beyond compiling this aggregate statistic, however, Revenue Canada did not perform any further financial analysis to determine how much of the net projected amount it could reasonably expect to collect, or how best to deploy resources to

maximize revenue generation and encourage compliance in reporting.

31.117 At the conclusion of our audit, the Department had not completed its projection of net recoverable amounts following the results of its random samples for the 1994 and 1995 tax years. How these compare with the 1993 aggregate statistic remains to be determined. The lag in compiling these aggregate statistics, coupled with the lack to date of any substantive analysis of compliance data on hand, indicate that financial management needs attention, given the potential amount of revenue involved.

# Organizational responsibility for financial management is shared and decentralized

31.118 Financial management at Revenue Canada cuts across every line of business and is part of every program (see Exhibit 31.11). It is not a separate system or a separate function, but is integral to almost every operation. Within each line of business, there are several program branches that provide functional and line direction, with regional operations deciding the method of delivery of programs. Headquarters deals with internal administrative matters and is responsible for managing many of the Department's fiduciary responsibilities. Exhibit 31.12 illustrates the organization of Revenue Canada and the existing reporting relationships.

31.119 Responsibility for financial management is shared and decentralized among headquarters, program branches and regional operations. Business lines are the responsibility of program branches and regional assistant deputy ministers, who determine their own financial management systems and practices for their respective areas of responsibility.

Headquarters determines the systems and practices for corporate-level management of resources and expenditures, and assesses overall funding requirements and strategies. Headquarters, program branches, and regional operations all share in maintaining books of account and subsidiary records as well as other necessary records for reporting to Parliament and other stakeholders.

31.120 The shared and decentralized financial management framework requires clear responsibilities, accountabilities and minimum fiduciary expectations. Lines of business are diverse, as are the various programs operating within them. No single formula is possible for financial management across the organization. This requires functional guidance and standards and an overall review and co-ordination of financial management practices and systems. We observed that this was not being done.

31.121 We noted that the Department has started to review the mandate of the internal audit function with a view to making it more independent and effective. However, for the period covered by our audit we found that internal audit had not been used effectively to provide overall assurance on the state of financial management corporate-wide. Its work was generally negotiated with program and regional assistant deputy ministers, who had the final say on the scope, nature and rigour of reviews to be undertaken. This

Internal audit has not been used effectively to provide overall assurance on the state of financial management.

Exhibit 31.11

Revenue Canada's Business Lines

.......

Assistance to Clients and Assessment of Returns

• Customs Border and Trade Administration Services

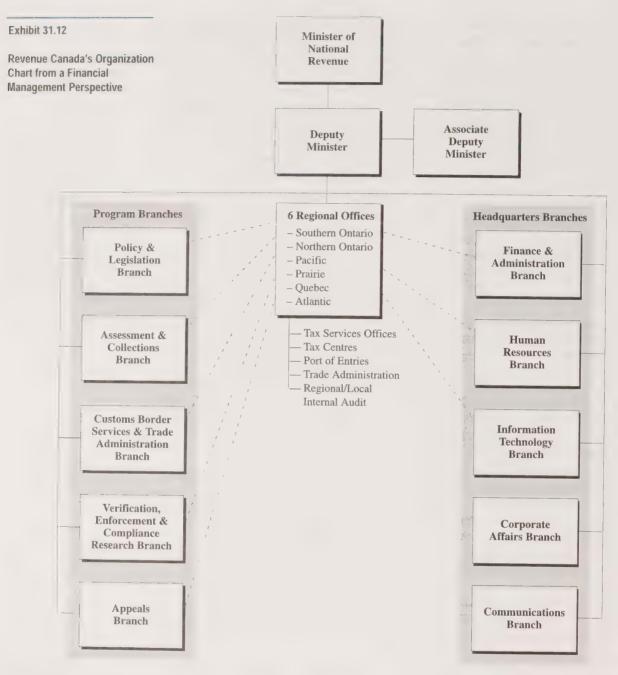
Verification and Enforcement

Revenue Collections

• Appeals All the family site by a line

Administration and Information Technology

**Source:** Revenue Canada – 1996–1997 Part III Estimates



Regions report to these Branches on matters that impact the Branch's programs and policies.

Direct reporting relationship

Source: 1997–1998 Part III Estimates

impacted on the quality of the work internal auditors could do and the level of independence they had in setting the audit scope.

31.122 Revenue Canada should strengthen the role of internal audit so that it can provide senior management with independent assurance on the state of financial management in the Department.

Department's response: A number of enhancements to the Department's review function (Internal Audit and Program Evaluation programs) are currently under way, including:

- establishment of a Senior Audit Committee (the Departmental Priorities Committee);
- the development and installation of new, comprehensive policies for both Internal Audit and Program Evaluation;
- planned modifications to reporting and follow-up formats and follow-up processes; and
- improvements to the Internal Audit and Program Evaluation planning process.

Collectively, these changes should significantly improve the Department's capacity to utilize the internal audit function, and more effectively provide an enhanced review and assurance capacity to the Department's financial management regime.

#### Conclusion

31.123 Revenue Canada has gone through a period of tremendous change, both organizational and legislative. Nevertheless, we found senior management quite cognizant of its responsibilities for financial management.

**31.124** Our examination revealed some areas of strength, no areas of neglect, but

several areas in need of improvement. Many bridging practices in the form of proxy measures, informal information systems, internal consultations, or reliance largely on the judgment and experience of individual managers have emerged across the organization and have helped reduce some of the risks — but basic shortcomings remain. While the use of such means to provide comfort on financial management issues may be acceptable in some limited circumstances, such an approach on an ongoing basis entails substantial potential financial risks.

31.125 We observed that much of the responsibility for minimizing financial risks and protecting financial assets lies with the program branches. Our audits in previous years have dealt with aspects of financial management within specific programs, noting that improvements were needed in several areas. We are generally satisfied with the Department's actions taken to date in dealing with our previous recommendations, but more remains to be done. The Department needs to sustain its momentum to resolve matters still outstanding.

31.126 We also noted that opportunities exist to improve performance in cash management across all business lines. Our analysis shows that while the vast majority of remittances are deposited by next business day, performance is uneven and is costing the government several millions of dollars in forgone interest revenue. We also found that the Department needs to exercise more rigour in quantitative objective challenge of business cases supporting its requests for new funding.

**31.127** Regarding those aspects of financial management that typically support management in achieving program objectives in an efficient and cost-effective manner, we found that the

Department has been proactive in formalizing strategic and operational plans that are tied to government objectives and priorities. Management contracts have also emerged, which are meant to further strengthen managers' accountability. We have significant concerns about the reliability of information meant for monitoring and analyzing program statistics. As the Department accelerates its shift to an information-based organization, it needs to check its data to ensure that they are in an appropriate form for analysis and are accurate.

31.128 We observed that the Department's systems are not efficiently supporting the financial reporting requirements of the federal government

and that practices in this area require more rigour. One particular concern is that Revenue Canada does not perform all of the reconciliations that we believe are needed for good financial management. Aside from revenue reporting, we found that stakeholder needs are largely met.

31.129 Overall, in our opinion, Revenue Canada is now at a stage of maturity where it needs to devote much more attention and assign a higher priority to ensuring effective and efficient financial management throughout the organization. We acknowledge that a number of departmental initiatives are either planned or under way that are poised to strengthen several aspects of the Department's financial management regime.



### **About the Audit**

#### **Objective**

Overall, our objectives were to determine whether:

- Revenue Canada's financial management function provides adequate safeguards to minimize financial risks and protect financial assets;
- the Department's financial management regime adequately supports management in achieving program objectives in an efficient and cost-effective manner:
  - the Department's strategic and operational plans reflect government priorities and legislated requirements;
  - adequate systems and practices are used by management to determine the resources required to meet commitments and to account for their use:
  - systems effectively provide necessary information to support accountability reporting, performance monitoring and financial risk management;
- there are adequate controls over the accuracy of revenue reports in *The Fiscal Monitor* and in the Public Accounts; and
- financial and departmental performance information provided to key stakeholders is sufficient, timely, relevant and reliable.

#### **Scope**

We examined financial management and control from three broad perspectives. Specifically, we looked at:

- the Department's handling of two of its key fiduciary responsibilities revenue reporting and cash management;
- the key administrative functions that underpin an effective financial management control regime namely, planning, budgeting, funding, performance monitoring and reporting; and
- the organization and priorities of Revenue Canada and how these affect its financial management control systems.

We limited our work to those systems and practices that support revenue-related operations. Our audit did not cover:

- the management and accuracy of the more than 22 million taxpayers' records that Revenue Canada maintains;
- the Department's operating expenditures;
- Revenue Canada's policies and practices for controlling fraud;
- the management of the Department's investment in facilities and other capital assets.

#### **Approach**

In carrying out our audit, we drew on knowledge gained from previous revenue-related audits that our Office has carried out over the past four years, updated to reflect the results of our follow-up work. All of those audits considered some aspects of financial management and control.

We conducted our audit work at Revenue Canada's headquarters and in all regional offices, and in several tax centres and tax services offices across Canada. We also interviewed officials at Statistics Canada, the Receiver General of Canada and the Department of Finance to learn about their respective roles in relation to financial reporting, including cash management, and in relation to the sufficiency, quality and reliability of financial and operational information in general supplied by Revenue Canada for input into tax policy, fiscal policy or economic and demographic forecasting.

We also visited officials of the Internal Revenue Service and the General Accounting Office in the U.S., and Inland Revenue and the National Accounting Office in the United Kingdom to obtain a perspective on overall trends in financial management and control and on initiatives to establish formal accountability structures for financial management and control in their respective jurisdictions. We also visited a major Canadian financial institution to obtain a private sector perspective on financial management and control practices in the banking industry for the areas covered in our audit. We also obtained their views on present banking arrangements for processing taxpayer remittances and other tax transactions.

#### **Audit Criteria**

We expected that:

- Responsibility for financial management and control would be clearly defined, and related accountability
  would be clearly established and monitored.
- Before it makes decisions, the Department would understand their financial implications backed by relevant, accurate, timely information and analysis and objective rigorous challenge as appropriate.
- The Department would have adequate systems and practices to identify and control financial risks.
- The Department's management information systems would produce the type of reliable information that it needs to properly plan, control and accurately account for funded resources to deliver on commitments.
- The Department would have clear, measurable performance expectations for its programs and operations
  and monitor the extent to which its results reflect its expectations. Managers would be held to account for
  results achieved.
- The Department would have systems for meeting legal reporting requirements and for providing any program, financial and performance information that Parliament, the central agencies and others might reasonably expect. This information would be complete, accurate, timely and relevant to their needs.
- The Department would comply with financial executive authority and central agency requirements in
  matters connected to keeping within established spending limits, ensuring that spending is as authorized,
  collecting revenues only as authorized, and recording and reporting revenues and expenditures as
  required.
- The Department would have appropriate and effective systems and procedures for cash management. Essential records would be maintained and procedures applied would be sufficient to secure an effective check on the assessment, collection and proper allocation of revenues.

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# Chapter 32

**Revenue Canada and Department of Finance** 

Understanding Changes in Tax Revenues: GST The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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# Revenue Canada and Department of Finance

Understanding Changes in Tax Revenues: GST

#### **Main Points**

- 32.1 Chapter 31 of this Report highlights the importance of appropriate, sufficient and timely analyses to understand fluctuations in various revenue streams. Good analyses can improve the government's ability to identify errors, increase the government's awareness of new economic trends, enhance the credibility of the financial information reported to Parliament, and improve the accuracy of the government's forecasts of tax revenues, deficits and net borrowing needs. Good analysis of revenue movements also supports Revenue Canada's programs and initiatives to identify tax avoidance techniques being used by registrants or to note changes in registrant compliance.
- 32.2 In this chapter, we consider what would constitute an appropriate process for analyzing movements in revenue streams, the minimum extent to which the process should be followed, and the factors that hamper the attempts of Revenue Canada and the Department of Finance to understand changes in tax revenues. To do so we selected, as an example, the \$400 million decrease in net Goods and Services Tax (GST) that occurred from 1994–95 to 1995–96 (from \$16.8 billion to \$16.4 billion), and reviewed the departments' attempts to analyze it.
- **32.3** Both Revenue Canada and Finance are satisfied that the amount of effort they devoted to finding an explanation for the decrease in net GST was appropriate given the size of the decrease and the nature of the available information. However, no conclusive explanation for the decrease has been found.
- 32.4 We believe that Revenue Canada and Finance followed an appropriate analytical process to a certain extent. We believe, however, that the process needs to be followed more fully. As a minimum, the departments need to adjust for bookkeeping errors and distortions caused by the cash basis of accounting before assessing the extent to which further analyses are required. If the need for further analysis is revealed, the departments could consider additional factors related to changes in the economy and in registrant behaviour to obtain a more robust explanation of changes in GST revenue.
- 32.5 Although the departments made attempts at analyzing the decrease in GST revenue, problems with the reliability and timely accessibility of some of the data, as well as the lack of other data, inhibited their efforts. Ensuring the reliability and timeliness of the data, and making more use of available and reliable data, would improve the departments' ability to conduct timely analyses. Collecting additional information from some or all registrants could improve the departments' analytical capabilities. The government will need to maintain a balance between its need for more information for analysis and compliance purposes and the increased burden it places on registrants to provide the information and on Revenue Canada to capture and store it.
- **32.6** Revenue Canada could improve its analytical capability by ensuring that a sufficient, proactive, timely and co-ordinated effort is mounted by the various units within the Department to analyze GST revenue.



#### Introduction

#### Focus of the audit

32.7 Many of our previous audits and Chapter 31 of this Report highlight the importance of appropriate, sufficient and timely financial analyses to understand fluctuations in various revenue streams. This chapter explores whether opportunities exist to improve the analyses of revenue movements performed by Revenue Canada and the Department of Finance. In our audit, we selected, as an example, the analyses carried out by the departments to understand the \$400 million decrease in net GST revenue from 1994–95 to 1995–96.

32.8 We selected the analyses of the \$400 million decrease for several reasons. First, the decrease had not been expected. In its 6 March 1996 Budget, the government forecast that net GST revenue for 1995–96 would be \$17.2 billion — a \$400 million increase over 1994–95 as opposed to a \$400 million decrease. Second, net GST had increased from 1992–93 to 1993–94 and from 1993–94 to 1994–95 (see Exhibit 32.1). Third, we were aware that the government had considered the decrease to be significant.

**32.9** Further details on the audit objective, scope and criteria are presented

at the end of the chapter in the section About the Audit.

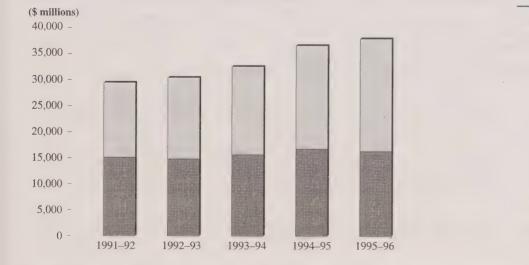
# Observations and Recommendations

## Why It Is Important to Understand Changes in Tax Revenues

32.10 It is important for Revenue Canada and the Department of Finance to analyze and explain fluctuations in all tax revenues, including GST. The better the analysis, the better the government's ability to identify errors, if any, in the amounts reported monthly in The Fiscal Monitor or annually in the Public Accounts of Canada. Good analysis can also increase the government's awareness of new economic trends, enhance the credibility of the financial information reported to Parliament, and improve the accuracy of the government's forecasts of tax revenues, deficits and net borrowing needs.

32.11 Good analysis of revenue movements supports Revenue Canada's programs and initiatives to identify tax avoidance techniques being used by registrants or to note changes in registrant compliance. Revenue Canada needs to identify developments such as these in

The \$400 million decrease in net GST had not been expected.



GST Amounts —
1991–92 to 1995–96

Refunds, Rebates and Other Payments

Net GST

Total of the two represents GST received

**Source:** Public Accounts of Canada, Volume 1

Exhibit 32.2 How the GST Works

	(Amounts in \$)					
	Sales (excluding GST)	Purchases (excluding GST)	GST on sales	Input Tax Credits	Cash receipts to Revenue Canada	Refund paid by Revenue Canada
Month 1						
Logger <sup>1</sup>	1,000		70		70	
Sawmill Operator <sup>1,2</sup>	1,500	1,000	105	(70)	35	
Manufacturer <sup>2</sup>		1,500		(105)		(105)
Month 2						
Manufacturer <sup>3</sup>	3,000		210		210	
Retailer <sup>3,4</sup>	5,000	3,000	350	(210)	140	
Totals			735	(385)	455	(105)
Net GST (equal	s amount paid by fi	inal consumer)	\$35	50 1	\$3	350

#### **Transactions:**

- <sup>1</sup> Logger sells logs to sawmill for \$1,000 plus \$70 GST
- <sup>2</sup> Sawmill sells lumber to furniture manufacturer for \$1,500 plus \$105 GST
- <sup>3</sup> Manufacturer sells furniture to retailer for \$3,000 plus \$210 GST
- <sup>4</sup> Retailer sells furniture to final consumer for \$5,000 plus \$350 GST

The exhibit assumes that all companies are registered to collect the GST, and file their GST returns on a monthly basis. (The GST returns would therefore be filed one month after the month in which the transaction occurred.) The exhibit also assumes that all sales are domestic.

The GST is a multi-stage sales tax in that, as a general rule, it applies to sales at all levels in a purchasing chain. For example, consider the manufacture and sale of furniture. The sawmill company pays GST when purchasing logs from the logger; the manufacturer pays GST when purchasing lumber from the sawmill; the retailer pays GST when purchasing furniture from the manufacturer; and the consumer pays GST when purchasing furniture from the retailer. In each case, the seller (registrant) collects the GST.

The intent of the GST legislation is to tax only the "value added" at each stage of the chain. To accomplish this, the seller at each level in the chain claims a refund for the GST that it has paid on its purchases. The amounts claimed are called input tax credits (ITCs).

For example, the retailer has collected \$350 in GST from its customer, and has claimed an ITC for the \$210 in GST that it paid to the manufacturer. The \$140 difference represents seven percent of the \$2,000 value added — the \$5,000 selling price less the \$3,000 purchase price.

Registrants do not normally remit the gross GST that they collect, or receive refunds for the gross GST that they pay. Rather, for each reporting period, they file a GST return on which they calculate the net GST that they owe or are owed. Then they either remit the net amount collected or receive a refund for the net amount paid.

The result is that the gross GST collected and collectable (referred to as "GST declared" in this chapter) and the ITCs claimed are much greater than Revenue Canada's cash receipts and refunds, and the net GST that the government retains.

Because registrants can claim ITCs for the GST that they pay, the final net GST the government gets to keep (\$350 in our example) is the GST paid by the final consumer (the customer of the retailer in our example). Cash paid by registrants at earlier stages in the chain is returned to them at later stages until, in the end, only the cash coming from final consumers remains with the government.

The discussion has implications for the analysis of GST revenue. The cash received and the refunds paid by Revenue Canada are net amounts. The GST declared and the ITCs claimed by registrants provide a better indication of the volume of activity throughout the chain. In addition, these gross amounts may not be as affected by timing differences, such as refunds being claimed in one month and amounts being remitted in another month. For these reasons, even though the gross amounts suffer some of the same shortcomings as cash receipts and refunds, they would be better bases to use for analysis than cash receipts and refunds.

The net tax kept by the government is the amount paid by final consumers. Therefore, a logical step in analyzing GST is to compare the net GST kept by the government with the total amount spent by final consumers on which GST had to be collected.

order to amend its compliance strategies accordingly.

32.12 The impacts of errors, distortions, economic trends, tax avoidance techniques and changes in registrant compliance may offset each other.

Therefore, even in the absence of large fluctuations, there need to be sufficient ongoing analyses to ensure that all items requiring action are identified. Such analyses would include the day-to-day work being performed by the various units within Revenue Canada and Finance to monitor, among other things, changes in the economy and in registrant behaviour.

# The analysis of the \$400 million decrease in net GST revenue was inconclusive

32.13 When analyzing the \$400 million decrease in net GST. Revenue Canada and Finance identified a number of factors that could have contributed to the decrease. These factors were documented in various internal documents, including several drafts of an internal "Analytical Note" that Finance prepared and discussed with Revenue Canada, However, the Analytical Note and the other internal documents came to no conclusion on which of the possible explanations were favoured, and the potential impact of some of the factors on net GST had not been determined. The impact of these unquantified factors could have been significant.

32.14 One of the possible explanations identified was "lags in processing of refunds and rebates pertaining to 1994–95." This was the explanation used in the *Annual Financial Report of the Government of Canada: Fiscal year 1995–96*, issued in October 1996. However, the Analytical Note and other documents provided to us did not contain sufficient support for the explanation.

**32.15** In our opinion, given the limited extent to which the process was followed (see paragraphs 32.20 to 32.24) and the

limitations of the data (see paragraphs 32.25 to 32.30), the analysis of the \$400 million decrease in net GST was inconclusive. To better understand this, we considered what would constitute an appropriate process for analyzing movements in GST and in other revenue streams, the minimum extent to which the process should be followed, and the factors that hampered the departments' attempts to understand changes in GST revenue. Our findings may point to ways in which the analytical capabilities of both departments can be strengthened so that future fluctuations in GST revenue can be better understood

#### How the GST works

32.16 To better understand the task faced by Revenue Canada and Finance in analyzing GST revenue, it is important to understand how the GST operates and the magnitude of the amounts involved. Exhibit 32.2 presents a simple example of how the GST operates, and notes two implications for the analysis of GST revenue. Exhibit 32.3 contains a "standard" GST return.

32.17 As illustrated in Exhibits 32.2 and 32.4, the gross GST collected and collectable (referred to as "GST declared" in this chapter) and the input tax credits (ITCs) claimed by registrants are much greater than Revenue Canada's cash receipts and refunds.

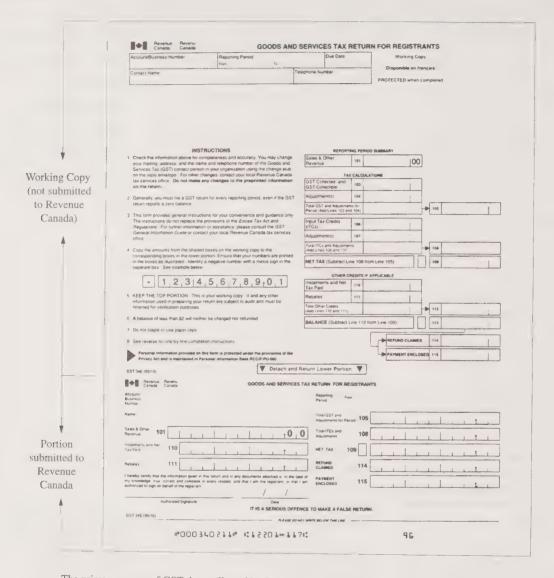
32.18 The gross amounts are also much greater than the net GST the government retains. Exhibit 32.4 shows that in 1995–96, for every dollar of net GST revenue kept by the government, registrants collected about \$4.30 of gross GST revenue from purchasers of goods and services. The difference of \$3.30 does not represent "leakage" in the system, or administrative costs of collecting the GST. Rather, it is a by-product of the mechanism used to ensure that only the value-added portion of transactions is taxed.

Even in the absence of large fluctuations, there need to be sufficient ongoing analyses to ensure that all items requiring action are identified.

The analysis of the \$400 million decrease in net GST was inconclusive.

#### Exhibit 32.3

#### The GST Return



The primary source of GST data collected by Revenue Canada is the GST return completed by registrants.

A "standard" return in use during 1995–96 for registrants outside the Province of Quebec is illustrated. (Though somewhat different in format, the Quebec return requested exactly the same GST information.)

The back of the form contains instructions on how to complete the return. For example, for line 101 (sales or other revenue), the back of the illustrated return instructed the registrant to "Enter the total sales and other revenue from your books and records or, if you are an annual filer, from your financial statements or equivalent. Do not include provincial sales tax and GST."

Only the bottom portion of the return is submitted to the government. As a result, Revenue Canada and the Department of Finance would not have the information with respect to adjustments entered on lines 104 and 107 on the top portion of the return (the working copy).

Exhibit 32.4

#### Comparison of GST Declared and Input Tax Credits (ITCs) Claimed with Cash Receipts and Refunds — 1995-96 (in \$millions)

	Illustrative Breakdown of GST Received per Public Accounts	Illustrative Breakdown of GST Refunds per Public Accounts	Reconciliation of GST Declared and ITCs Claimed to Net GST per Public Accounts
GST Declared	A \$60,000	B \$33,500	C \$93,500
ITCs Claimed	D (21,900)	E (50,000)	F (71,900) <sup>1</sup>
GST per Public Accounts before Items Listed below	G \$38,100	H \$(16,500)	I 21,600
Rebates, Paid by Government Ministries to Registrants and Quarterly Tax Credits <sup>2</sup>			J 5,200
Net GST			K \$16,400

The amounts in boxes C and F can be extracted from Revenue Canada's accounting systems. Box C is composed of, among other things, amounts reported by registrants on their GST returns and GST collected at the border by Customs. Box F is composed of, among other things, amounts claimed by registrants on their GST returns. Except for the portion of the box C amount collected at the border by Customs, these amounts are unaudited.

The amounts in boxes G, H, I, J and K are available from Revenue Canada's accounting systems, and have been audited as part of our audit of the Public Accounts of Canada.

The amounts in boxes A, B, D and E are not available. While the data required to produce these amounts are captured by Revenue Canada's accounting systems, these systems were not designed to track GST declared and ITCs claimed separately for GST returns with receipts and GST returns with refunds. We have entered fictitious amounts in these boxes for illustrative purposes only.

The purpose of this illustration is to show that the cash receipt and refund amounts (boxes G and H) reported by the government do not contain important information that is needed for an analysis of GST revenue movements. They also do not show the extent of the turnover of transactions associated with a multi-stage sales tax like the GST: for every dollar of net GST revenue retained by the government, about \$4.30 (\$93,500 million divided by \$21,600 million) is collected from purchasers of goods and services.

- <sup>1</sup> For 1995–96, the net GST position, using GST declared (box C) and ITCs claimed (box F), was approximately \$500 million less than the \$21,600 million in the Public Accounts of Canada. The difference could have been caused by numerous factors, such as a registrant submitting a GST return in 1995–96 but Revenue Canada not issuing the refund cheque until 1996–97. While the difference would most likely relate to both boxes C and F, for simplicity we have reflected all of it in box F.
- <sup>2</sup> The quarterly tax credits represent \$2,800 million of the \$5,200 million in box J. These credits are paid to families and individuals with low or modest incomes to help them offset all or part of the GST that they pay. As such, they represent a social transfer program, and are not part of the GST system itself. They are included in this exhibit as this is how the government reports them in the Public Accounts of Canada.

Source: Revenue Canada and/or the Public Accounts of Canada – amounts in boxes C, F, G, H, I, J and K.

Four requirements to understand changes in GST revenue are: following an appropriate process, having reliable and timely data, co-ordinating the analyses and obtaining enough information.

## What Is Needed to Understand Changes in GST Revenue

32.19 This section discusses four requirements to understand changes in GST revenue — following an appropriate process, having and making use of reliable and timely data, co-ordinating the analyses among the decentralized units within Revenue Canada, and obtaining enough information from registrants.

## Following an appropriate analytical process

32.20 Exhibit 32.5 outlines a process for analyzing GST revenue movements. We believe that the process is appropriate for analyzing movements in all revenue streams and for analyzing both variances from budgeted amounts and changes from previous years' actual amounts. Revenue Canada and Finance officials have informed us that this is the process that they generally follow. The process reflects the cash basis of accounting being used by the government for recording tax revenues. However, this basis of accounting could distort the reported GST amounts. For example, slower processing of GST refunds by Revenue Canada at the end of 1994-95 would mean that refunds normally issued in 1994-95 would be issued in 1995-96. As a result, GST

revenue would be higher in 1994–95 and lower in 1995–96.

- 32.21 We believe that, even in the absence of large fluctuations, as a minimum the first three steps of the process outlined in Exhibit 32.5 need to be performed. This is to ensure that bookkeeping errors or distortions caused by the cash basis of accounting are not concealing large variations caused by changes in the economy or changes in registrant behaviour.
- Revenue Canada and Finance did not complete steps 2 and 3 of the process. As part of step 2, they identified \$245 million in bookkeeping errors, but did not fully perform certain reconciliations and other procedures required to detect misclassifications between GST and other revenue streams, such as customs import duties or corporate income tax. Eliminating the identified bookkeeping errors leaves an apparent unexplained residual of \$155 million. However, because the departments did not complete step 2 and because, for step 3, they did not fully investigate a number of potential distortions caused by the cash basis of accounting, it is not safe to conclude that \$155 million is the amount of the residual to be explained. Some of the potential distortions were significantly large to pose a risk that the residual could have been much greater than

Exhibit 32.5

An Appropriate Process for Analyzing GST Revenue Movements

- 1. Start with amounts for both years using the government's cash basis of accounting.
- 2. Adjust these amounts for known bookkeeping errors in each year.
- 3. Adjust these amounts further to eliminate distortions caused by the cash basis of accounting.
- 4. Consider the impact of changes in the economy on the adjusted amounts.
- 5. Consider the impact of changes in registrant behaviour on the adjusted amounts.

While this chapter only deals with the analysis of a change in GST revenue from the previous year's actual, we believe that the process would also be appropriate for other revenue streams and for analyzing variances from budgeted amounts.

The process reflects the cash basis of accounting currently being used by the government for recording tax revenues. However, the government has announced its intention to implement accrual accounting for tax revenues. When accrual accounting has been implemented, steps 1 and 3 of the process will require amendment.

\$155 million. If this were so, it would have affected the departments' need to perform steps 4 and 5 of the process.

32.23 For steps 4 and 5 of the process, the departments could have considered additional circumstances affecting GST revenue. For example, for step 4 they could have more fully considered changes in economic factors. For step 5, they could have more fully considered the potential impacts of registrants' increased knowledge of the GST legislation.

32.24 When analyzing GST revenue movements, Revenue Canada and the Department of Finance should, as a minimum, adjust for bookkeeping errors and distortions caused by the cash basis of accounting, and then assess the extent to which further analyses are required. The required analyses should then be performed.

Departments' joint response: As noted in the Main Points, Revenue Canada and the Department of Finance followed the appropriate analytical process for the analysis of the \$400 million decline in GST revenues. While it is important to understand changes in collections from year to year, it is also important to compare the outcome to the budget forecast based on underlying economic developments affecting the tax base. The focus of Finance's work was explaining the forecast variance, as well as the year-to-year change.

The Analytical Note put forward a number of possible factors that could have contributed to the forecast variance. The potential contributions of these factors were evaluated by looking at all available relevant data and information. In some instances, certain pieces of information were viewed as unreliable for making precise quantitative estimates of the impact of some factors. In some other instances, the data were not available on a timely basis to contribute to the analysis. For example, the historical revisions to Statistics Canada data, which we will use

to refine our estimate of the underlying GST base, have not yet been released.

In addition to analysis conducted specifically to answer questions related to issues raised in the Analytical Note. Revenue Canada and Finance drew upon their ongoing day-to-day monitoring and analysis of GST revenues to guide them as to the potential importance of certain factors. At the aggregate level, the departments track trends in revenue performance for all revenue sources. Additional analysis of the various revenue components is undertaken to examine compliance patterns and identify potential problems. For the GST, analysis is undertaken at the individual registrant level to assess all GST returns, including ITCs claimed, credit returns and rebates. for risk of non-compliance.

In our view, revisions to the economic data, together with the identified bookkeeping adjustments, account for the variance in the revenue forecast.

Accordingly, Revenue Canada and Finance are satisfied that they have adequately explained why GST revenues came in below forecast. That said, we will continue to revisit this issue as new and revised economic data for this period become available.

We would also note that after taking into account the \$245 million in adjustments referred to in paragraph 32.22, the decline in GST would have been about \$150 million or half of one per cent of gross GST revenues. This is well within the range of normal month-to-month fluctuations in GST revenues and the materiality threshold for analysis purposes.

### Having and making appropriate use of reliable and timely data

**32.25** To adequately follow an analytical process, Revenue Canada and the Department of Finance need to have, and to make appropriate use of, reliable and timely data. In our previous audits, we have expressed concerns about the

There is a need to ensure that bookkeeping errors or distortions caused by the cash basis of accounting are not concealing large variations caused by changes in the economy or changes in registrant behaviour.

Revenue Canada and the Department of Finance need to have, and to make appropriate use of, reliable and timely data.

reliability of the data emanating from Revenue Canada's systems. Moreover, Chapter 31 of this Report notes significant ongoing concerns about the reliability of information meant for use in monitoring and analyzing program statistics, trends and performance.

32.26 Exhibit 32.6 lists some of the data that the departments had available to explain the \$400 million decrease in net GST. Some of the data were not used; other data were not used to the extent required to explain the decrease. Finance officials have informed us that they have concerns about the reliability and the timeliness of some of the data that they did not use.

32.27 The analyses performed by Revenue Canada and Finance were based primarily on receipts and refunds. The data listed in Exhibit 32.6 include GST declared and input tax credits (ITCs) claimed. We believe these would be better bases to use for analysis purposes. There are concerns, though, about the reliability of the recorded amounts for GST declared and ITCs claimed because they are not reconciled to the cash receipts and refunds. Revenue Canada regards the performance of this reconciliation to be a formidable task.

32.28 As noted in Chapter 31, Revenue Canada has recognized that some inefficiencies exist in current systems and these are being addressed as part of a major re-engineering initiative currently under way in the Department.

32.29 Revenue Canada and the Department of Finance should continue to work toward improving the reliability and the timeliness of the GST data, and should make more use of available and reliable data to the extent called for during each step of the analytical process.

Departments' joint response: Revenue Canada, in consultation with the Department of Finance, is continuing its efforts to improve the quality and timeliness of information used for revenue analysis and other purposes. The re-engineering process that is currently under way, which includes the standardization of accounting systems, should be particularly helpful in this regard. Finance will continue to monitor and analyze economic developments with regard to their impact on revenue flows.

32.30 Revenue Canada should find ways to reconcile the net of the GST declared and input tax credits claimed

Exhibit 32.6

Available Data

Data that Revenue Canada and the Department of Finance had available to explain the \$400 million decrease in net GST include:

- information such as GST receivables, refunds payable and GST offsets (applying what would otherwise have been a GST refund to amounts owing for other revenue streams) that could be used to identify distortions caused by the cash basis of accounting;
- industry sector data that could be used to determine the sectors in which the fluctuations have occurred, and the composition of registrants within those sectors;
- information on GST returns submitted by registrants, including the amounts for sales, GST declared and input tax credits claimed;
- additional GST information pertaining to individual registrants, such as the results of reviews of GST returns prior to issuing refund cheques;
- aggregate and individual registrant data from other revenue streams, such as customs import duties and excise taxes and duties;
- monthly GST data that can be used to indicate the months in which unexplained differences had occurred; and
- economic data from the System of National Accounts provided by Statistics Canada.

to the net of the cash receipts and refunds.

Departments' joint response: The suggested reconciliation is not feasible in the context of the current accounting structure of the GST mainframe system, which was built on the concept of reporting in the Public Accounts on a modified cash basis. It will be considered as part of the move to standardize accounting systems and the government's intention to move to full accrual accounting.

### Co-ordinating analyses among decentralized units

32.31 Some GST analyses, such as a detailed consideration of economic factors, would best be performed by the Department of Finance. Other GST analyses would best be performed by Revenue Canada. These include, for example, a comparison of GST data with data from other revenue streams, and analyses at the individual registrant level.

32.32 Revenue Canada has a shared and decentralized financial management framework. Responsibility for the performance of analyses for GST and other revenue streams is shared among. for example, Revenue Canada's Finance and Administration at headquarters and the various program branches and directorates, such as Compliance Research. An interdepartmental Fiscal Monitor Committee, with representatives from both Revenue Canada and the Department of Finance, deals with reporting issues. It is largely in this forum that questions on revenue fluctuations are raised by Finance for follow-up or analysis by Revenue Canada. While Revenue Canada and Finance officials believe that the Fiscal Monitor Committee is providing a good forum for dealing with issues and for understanding respective needs and constraints, Finance would like Revenue Canada to do more independent

analysis and, in response to queries raised, more timely analyses.

32.33 As noted in Chapter 31, it was not evident that there was any guidance provided by Revenue Canada headquarters to the program branches and directorates on the nature and frequency of routine analyses to be performed, or on the sources of information to be used. We also found that program branches are not provided with any parameters on what constitutes significant fluctuations requiring investigation. For the most part, analyses are performed only on a reactive basis (not a proactive basis). As a result, they may be done too late, or may not be done at all. Revenue Canada officials have informed us that, in concert with Finance. they will continue to develop specific performance measures that prompt investigative action and will report on them regularly.

32.34 Revenue Canada should ensure that a sufficient, proactive, timely and co-ordinated effort is mounted by the various units within the Department to analyze GST revenue.

Departments' joint response: In addition to the response to recommendation 32.24. the Fiscal Monitor Committee, which is co-chaired by the Director General. Financial Administration at Revenue Canada and the Director, Fiscal Policy, Department of Finance, co-ordinates revenue analysis activities. The committee has representatives from all program revenue branches. The Revenue Accounting and Reporting Division within the Financial Administration Directorate supports its activities. A year ago, terms of reference were established for the Fiscal Monitor Committee to ensure a common understanding of the expectations and respective roles in revenue analysis and to support the monthly revenue analysis cycle, which had been followed in an informal manner for some years.

Some GST analyses would best be performed by the Department of Finance. Other GST analyses would best be performed by Revenue Canada.

The GST return asks for very little information.

Obtaining more information from registrants would give Revenue Canada and Finance more confidence in the reliability of the amounts being reported, and more information for analysis and enforcement purposes.

### Obtaining enough information from GST registrants

32.35 Although improving the reliability and the timeliness of the data, and making better use of them, would improve the ability of Revenue Canada and Finance to analyze GST revenue movements, it may not be enough. Additional registrant data may be required.

The GST return (Exhibit 32.3) 32.36 asks for very little information. For example, it does not require the registrant to provide any breakdown of the sales amount into its taxable and non-taxable components. In addition, when the Harmonized Sales Tax (HST) was introduced, the GST return was not amended to require registrants to provide a breakdown of the sales amount to distinguish sales made in the three Atlantic provinces subject to the HST (taxed at 15 percent) and sales made in the rest of Canada (taxed at 7 percent). Changes in the ratio of taxable sales to total sales, or in the ratio of sales taxed at 15 percent to sales taxed at 7 percent, would distort the relationship between total sales and GST declared. In addition, the portion of the GST return submitted to Revenue Canada does not include the "adjustments" amount reported in line 104 on the top part of the return (the working copy). Large adjustments could also distort the relationship between sales and GST declared.

32.37 One way for Revenue Canada and Finance to obtain more information on sales and GST declared would be to amend the portion of the GST return submitted to Revenue Canada by some or all registrants to include adjustments and additional information on the sales amount.

**32.38** An alternative, which could provide even more information on sales but at greater cost to the affected registrants, would be to require some or all registrants to provide an annual

reconciliation of sales reported on their financial statements to the sales reported on their GST returns for the year. This reconciliation could be included as part of the registrant's corporate income tax return (incorporated registrants) or personal income tax return (unincorporated registrants). It could include information on sales of capital assets and the main categories of non-taxable sales.

32.39 Similar arguments can be made regarding the need to clarify what is included in the purchases and related input tax credits being claimed by registrants. Currently, there is no requirement for registrants to provide an amount for purchases on their GST returns.

Trade-offs. Obtaining more 32.40 information from registrants would give Revenue Canada and Finance more confidence in the reliability of the amounts being reported, and more information for analysis and enforcement purposes. However, it would increase the registrants' administrative burden. While some registrants may have this information readily available, others may not. The government will need to maintain a balance between its need for more information for analysis and enforcement purposes and the increased burden it places on registrants to provide the information and on Revenue Canada to capture and store it.

32.41 If Revenue Canada and the Department of Finance are unable to adequately explain fluctuations in GST, even after improving the reliability and timeliness of the available information and making better use of it, they should consider requesting additional information from some or all registrants.

Departments' joint response: As the Auditor General indicates, there is a need to balance the desirability of additional information for analytical purposes with the additional burden that requiring reporting of this information imposes on

taxpayers. The Department of Finance and Revenue Canada will continue to monitor the level of information required from registrants to ensure that this is appropriate in light of these considerations.

### Conclusion

32.42 In this chapter, we considered what would constitute an appropriate process for analyzing movements in revenue streams, the minimum extent to which the process should be followed, and the factors that hampered the attempts of Revenue Canada and the Department of Finance to understand changes in tax revenues. To do this, we selected, as an example, the \$400 million decrease in net

GST that occurred from 1994–95 to 1995–96 and reviewed the departments' attempts to analyze it. We found that while the process was followed to some extent, the departments had not completed what we consider to be the minimum procedures required.

32.43 To the extent that analyses of GST revenue are hampered by unreliable, untimely and unavailable data, it is important that Revenue Canada and Finance work toward improving the quality and timeliness of the data, and consider requesting more information from registrants. Co-ordinating analyses of GST within Revenue Canada could improve the Department's analytical capability.



### **About the Audit**

### **Objective**

The objective of this audit was to determine whether opportunities exist to improve the analyses of GST revenue movements.

### Scope

We assessed the nature and extent of the analyses carried out by Revenue Canada and the Department of Finance to explain the \$400 million decrease in net GST revenue from 1994–95 to 1995–96.

We did not review the forecasting methodology used by the Department of Finance. Nor did we attempt to assess the nature and extent of the analyses performed to explain the \$800 million difference between the 6 March 1996 Budget forecast and actual GST revenue.

Our examination was conducted in the headquarters of Revenue Canada and of the Department of Finance. It consisted of interviews and a review of the analyses performed by the departments and of other relevant documents.

The scope of the audit was co-ordinated with that of Chapter 31, Revenue Canada — The Financial Management Regime.

### Criteria

We expected that Revenue Canada and the Department of Finance would be able to identify and adequately explain significant variances in GST revenue. More specifically, we expected that the departments would:

- follow an appropriate analytical process;
- ensure that the data required to perform the analyses were reliable and available on a timely basis;
- perform rigorous analyses, making appropriate use of the data;
- co-ordinate the analyses among the various units within the departments; and
- explain the variance clearly and accurately in both internal and external reports.

### **Audit Team**

Mimi Hong Patricia Smith

For information, please contact Scott Milne or Jim Ralston, the responsible auditors.

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Chapter 33
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Report of the Auditor General of Canada to the House of Commons

Chapter 33
The Correctional Investigator Canada

December 1997

This December 1997 Report comprises 16 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, October and December 1997 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.



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### Chapter 33

The Correctional Investigator Canada

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Assistant Auditor General: Maria Barrados Responsible Auditor: Robert W. Chen

### **The Correctional Investigator Canada**

### **Main Points**

- 33.1 The Office of the Correctional Investigator was first established in 1973 under the *Inquiry Act*, and formalized in 1992 under the *Corrections and Conditional Released Act* "to conduct investigations into the problems of offenders". Although it is a small agency, the Office plays a very important role in ensuring fairness for those inmates serving sentences in Canada's federal prisons. Its findings and recommendations can also help to improve systems and practices in Correctional Service Canada.
- 33.2 Over the years, the Office has accumulated a set of management practices. We found that while these practices are often helpful in resolving individual complaints, they are not conducive to efficient and consistent handling of cases and have contributed to the Office's adversarial relationship with Correctional Service.
- 33.3 The Office needs to improve its operational strategies and management practices to reflect changes that have occurred in the correctional environment and in legislation since 1973. The Office needs to prioritize its activities on an informed basis in order to effectively manage its workload. It needs to establish policies and procedures to help its staff in investigating individual complaints. It also needs to improve the quality of its management information systems and provide better performance information in its annual reports.
- 33.4 Given the important role of the Office, improvements in its management are needed so it can better fulfil its mandate within the Canadian criminal justice system.



### Introduction

### The role of the Correctional Investigator

33.5 The Office of the Correctional Investigator (the Office) is a federal entity that deals with the complaints of inmates who are serving sentences of longer than two years in federal corrections facilities. The Office has 16 full-time-equivalent staff, all located in Ottawa. It is headed by the Correctional Investigator, who is supported by an executive director, a legal advisor, two directors of investigations, eight investigators and a small group of administrative support staff.

33.6 The Office's total annual budget is \$1.3 million, of which approximately \$1 million is for salaries and related personnel costs. The balance is used for operating expenses such as transportation, communications, utilities and supplies. Its work entails regular visits to more than 40 federal correctional facilities.

33.7 The Correctional Investigator's role is to receive, investigate and report on complaints by individual inmates and on system-wide issues that give rise to these complaints. He may also investigate problems on his own initiative, and any problems brought to his attention by the Solicitor General. He also has authority to recommend changes to the applicable law, practices or policies, where appropriate. The Correctional Investigator has wide discretion to decide whether an investigation should be undertaken; however, the Act sets out how it should be brought to conclusion.

### The importance of having a corrections ombudsman in Canada

33.8 Even though he heads a small agency with a small budget, the Correctional Investigator plays a very important role as ombudsman for the approximately 15,000 inmates of Canada's federal prisons. In 1971, following a riot

at Kingston Penitentiary, a Commission of Inquiry concluded that an external grievance body was needed to independently review inmate complaints and thereby reduce the potential for future occurrence of similar disturbances. In 1973, pursuant to Part II of the *Inquiries Act*, the government appointed a commissioner to be known as the Correctional Investigator.

33.9 In 1992 the position of Correctional Investigator was established formally in Part III of the *Corrections and Conditional Release Act (CCRA)*. The mandate of the agency is to "conduct investigations into the problems of offenders".

### The general role of an ombudsman

33.10 The notion of righting a wrong is central to the ombudsman role. An ombudsman exists to provide an independent, objective opinion on the fairness of government services — to counterbalance the relative strength of public institutions against the individual. A successful ombudsman is one who increases the public's confidence in public administration.

33.11 Some of the more common features of ombudsman offices, including the Correctional Investigator's, are the following:

- They emphasize easy access for all individuals requiring the service.
  - They have powers of investigation.
- They make non-binding recommendations.

This last feature — the non-binding nature of the recommendations — is considered critical because it ensures that the ombudsman will not become just another component of management. If the ombudsman is to remain effective, he or she must be perceived by both the public and the bureaucracy as completely independent and impartial.

The mandate of the agency is to "conduct investigations into the problems of offenders".

By providing an external review, the Correctional Investigator is in a good position to redress individual injustices and to address the defects in the system ("systemic issues") that are causing inmates to complain.

33.12 An ombudsman's strength lies in the ability to persuade others of the value of any recommendation or opinion flowing from an investigation.

Consequently, the working relationship between the ombudsman and the institutions within the scope of his or her mandate must be carefully balanced. The nature of the work implies that this relationship can be neither too cordial nor too adversarial. This balance of creative tension is not easy to achieve, but it is very important.

### Providing the service

33.13 The process the Office administers is complaint-driven. Complaints may be made in writing or orally — in the latter case, to investigative staff either during an institutional visit or by telephone (inmates may place a collect call to the Office). An inmate may raise his complaint with the Correctional Investigator, or friends and family members may do so on his behalf. After the Office receives a complaint by mail or by telephone, an interview may be scheduled for the next institutional visit by Correctional Investigator staff. In 1996-97, they conducted more than 2,000 interviews.

33.14 Typically, problems raised by inmates relate either to conditions in the institutions, such as pay and health care, or to decisions of Correctional Service Canada staff, such as those related to transfers, temporary absences and visits. What the Office of the Correctional Investigator does, broadly speaking, is to intervene formally or informally on behalf of an inmate when it receives a complaint. This usually involves trying to resolve the

complaint with Correctional Service officials.

33.15 The Office is also involved in providing information and advice to inmates. Sometimes the inmate is advised to first exhaust Correctional Service's internal complaint process, which consists of four levels, two of which are specific to the institution where the inmate resides. The remaining two levels are administered at regional headquarters and national headquarters respectively (see Exhibit 33.1).

33.16 In other cases, the Correctional Investigator's staff will intervene by pursuing the matter with Correctional Service staff. This kind of assistance often leads to a speedy resolution of the problem, if the two sides of an issue can be reconciled without formalities. In cases where there is an oversight, Correctional Service will take remedial action.

33.17 By providing an external review, the Correctional Investigator is in a good position to redress individual injustices and to address the defects in the system ("systemic issues") that are causing inmates to complain. As is true for other corrections ombudsman, the Office can also fulfil the function of "safety valve".

#### Focus of the audit

33.18 The aim of our audit was to determine the extent to which the policies and procedures of the Office of the Correctional Investigator have enabled it to carry out its mandate effectively. We focussed our examination on how well the Office has managed its operations, measured its performance and reported on the results of its work. Details on our audit

#### Exhibit 33.1

Volume of Complaints and Grievances (1996–97) in Correctional Service's Four-Level Grievance System

Level	Responsible Correctional Service Officer	Volume
Complaint	Section Head in Institution	16,600
First Level Grievance	Warden or District Director	2,953
Second Level Grievance	Deputy Commissioner in Region	1,889
Third Level Grievance	Commissioner's Representative at Headquarters	822

scope and criteria can be found at the end of the chapter, in **About the Audit**. Our audit did not include a review of Correctional Service Canada, other than its dealings with the Correctional Investigator relating to inmate complaints.

33.19 In addition to interviewing Correctional Investigator staff, examining the Office's documents and reviewing sample case files, our audit work involved interviews with inmates, Correctional Service Canada personnel and other stakeholders, as well as other ombudsmen, both past and present.

33.20 We reviewed the annual reports of a number of other ombudsmen, both general ombudsman and corrections ombudsman; some of their policy and procedures manuals; as well as reports and proceedings of parliamentary committees. We also conducted an extensive literature review.

33.21 Although the Office's clients include both inmates and offenders under community supervision, the bulk of its work is with inmates. For simplification, we use the term "inmates" throughout the chapter and in the male gender, although there are also female inmates.

### Observations and Recommendations

### **Mandate and Strategy**

Plans lack action steps to deal with recognized problems

33.22 Imprisonment is a condition that, by nature, creates tension and dissatisfaction and leads to many complaints. The demand for the Office's services is incessant. As it has reported, both the demand for its services and the complexity of the issues involved have increased in recent years. Yet the Correctional Investigator is still expected to meet mandated responsibilities such as

informing inmates of its existence and function, investigating their problems, making recommendations to solve the problems, and reviewing all investigations by Correctional Service into incidents of death or serious bodily injury.

Under these conditions, it is important that the Office set priorities among its activities and develop a plan for carrying them out. Such a plan of action would focus the Correctional Investigator's efforts on the most important of its mandated responsibilities, and enable the organization to make the best use of its resources. The Correctional Investigator prepares an expenditure plan for the Estimates and a business plan. However, while the Office identifies a number of initiatives, it does not clearly set out action steps, their relative priorities, and how they are going to be resourced. For example, our audit found that although the Office of the Correctional Investigator has identified coping with the volume of workload and maintaining a thorough and responsive investigative process as the most critical issues, it does not have an action plan that can address these issues effectively in relation to its other ongoing activities.

#### Managing the workload

33.24 The Office of the Correctional Investigator operates with a small staff. The staff have indicated that they feel overwhelmed by demand and volume. Our audit also found that the Office had problems with managing the work processes, providing timely responses to complaints and maintaining the number of visits to the institutions.

33.25 Last year the Office received approximately 7,000 contacts from inmates and their families. Each contact requires time and attention to determine how it should be dealt with. Some involve little work, while others can result in significant investigative effort. The Correctional Investigator estimates that, on average, the caseload is approximately

As the Correctional Investigator has reported, both the demand for the Office's services and the complexity of the issues involved have increased in recent years.

850 contacts per investigator. This is in addition to other responsibilities arising from the new legislation and other initiatives.

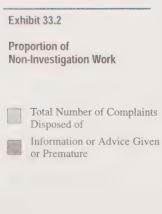
The Office does not differentiate 33.26 among contacts according to the extent of the work required. According to statistics it has reported, contacts by inmates that were dealt with by giving information or advice, or concluded to be "premature", have grown in proportion from 43 percent in 1992-93 to 56 percent in 1995-96 (see Exhibit 33.2). Providing information and advice can be beneficial to inmates, especially because they do not always have easy access to other sources. However, there is no guidance provided to investigators that sets out a more streamlined process for the contacts requiring least attention. Better management of requests for information and advice can free up some of the Office's limited resources for activities such as investigating inmates' complaints to the extent defined in the legislation and conducting systemic reviews that deal with the root causes of the complaints.

33.27 An inmate is not required to exhaust all of Correctional Service Canada's internal avenues of redress before seeking the Correctional Investigator's involvement. Consequently, when a complaint is received by the

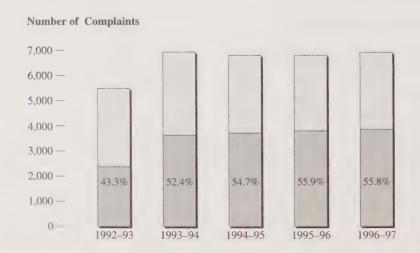
Office, the investigative staff often suggest to the inmate that he first discuss it with institutional staff or pursue the internal grievance process. Our data analysis revealed that cases like this represent approximately 50 percent of all cases received by the Correctional Investigator. These could include some of the contacts concluded by giving information or advice or closed as premature.

33.28 We estimated that in 15 to 38 percent of the cases, the inmate had contacted both the Office and Correctional Service with the same complaint. We were unable to determine the exact number of such cases because the two organizations use different classification schemes for complaints.

As provided for in the legislation, 33.29 the Correctional Investigator exercises his discretion to be involved at the same time as Correctional Service because he has concluded that Correctional Service's internal process does not always reasonably address the area of concern. Indeed, Correctional Service has been revising its grievance process due, in part, to concerns raised by the Correctional Investigator. In our opinion, however, some of this overlap may be unnecessary. The Correctional Investigator needs to address this overlap with Correctional Service as part of developing an overall







strategy for managing the Office's workload more effectively.

33.30 The Correctional Investigator should improve the management of its workload by reducing the overlap between its complaints process and Correctional Service Canada's internal grievance procedure, and by more clearly differentiating among the processes required to deal with different types of contacts.

The Correctional Investigator Canada's response: The Office accepts this recommendation and acknowledges current difficulties in managing our workload.

The Office has been aware for some time of the strain our intake process was placing on our resources. This became even more evident as we attempted, in line with the strategy detailed in the 1997–98 Main Estimates, to expand our participation in consultations with the Correctional Service on systemic areas of concern.

Accordingly, the Office has reduced telephone access on non-emergency matters and has taken steps to ensure a more consistent and frequent presence in the institutions to meet with inmates. Prior to the change in our telephone access policy, the Office was receiving 50 to 60 telephone calls per day. Guidelines for our intake process (initial contact) will be developed to provide a more standardized approach to decisions on categorization, referral and intervention in response to these contacts.

The Office's workload, in part, is determined by the effectiveness of Correctional Service's internal mechanisms for addressing inmate complaints. Although the Correctional Investigator has, in the past, been critical of the Service's inmate grievance process, recent improvements have been noted. This Office will continue to work with Correctional Service as it develops new

policies and procedures related to this process, so as to co-operatively identify matters that are unnecessarily being referred to both organizations and an effective method of ensuring that the issues are addressed at the outset by the appropriate organization.

### A communication strategy is needed

33.31 An ombudsman service is useful only if potential clients know of its existence. Given their intrinsic value, communications strategies have become an integral part of most ombudsman offices. Indeed, the Act directs the Correctional Investigator to maintain a program of communicating information to offenders concerning the function of the Office, the circumstances under which an investigation may be commenced and the independence of the Office.

33.32 A communication strategy serves two important purposes. The first is to "advertise" the service. The second is to explain the ombudsman's function to those for whom the service exists and to describe what his office can and cannot do. Clients' understanding of what is and is not possible reduces the potential for frustration. It could also reduce the volume of unnecessary requests and create some efficiencies.

33.33 So far, the Office has relied on the information provided in Correctional Service's induction package to inform inmates of its existence and its mandate. The package provides a brief explanation of the Correctional Investigator's role, including his independence from Correctional Service, and a phone number and address where he can be reached. In an attempt to inform the client base, the Office also sends its annual report to the inmate library in all Correctional Service institutions. It also seeks feedback on the annual report from a group of selected inmates.

**33.34** As a way of promoting access and providing information, investigative

The Correctional
Investigator needs to
address the overlap
with Correctional
Service as part of
developing an overall
strategy for managing
workload more
effectively.

Before intervening, the Correctional Investigator needs to define the suspected problem — not only to meet the intent of the legislation but also to help identify the root causes of systemic issues in the Correctional Service and suggest remedies.

staff try to visit each Correctional Service institution every six to eight weeks. During these visits, they meet with individual inmates as well as various inmate committees. For those inmates whose social skills, are severely limited, a face-to-face encounter is the only way they can raise their concerns with the Correctional Investigator. We noted that in the last few years, visits by staff to the institutions have not been as frequent as planned and have not been distributed equally among the institutions. Our consultation with some of the stakeholders in the criminal justice field suggests that maintaining inmates' access to the Correctional Investigator through staff visits needs to be assigned high priority.

We noted that corrections 33.35 ombudsmen in other jurisdictions have gone further in their efforts to communicate. They recognize that the proportion of illiteracy and of learning disabilities among prisoners is significant and that not all inmates understand French or English. To meet this challenge, some of them have used videos and posters and distributed leaflets in languages other than English and French to reach the inmate population. Some have compared the profile of current users with the profile of the general inmate population as a way of identifying gaps in their service.

33.36 We feel it is important for an ombudsman such as the Correctional Investigator to ensure that his service is well known and accessible to all inmates who need it. It would be feasible for the Office to determine where there might be a need for a more directed approach to informing offenders of his mandate.

33.37 The Correctional Investigator should develop and implement an action plan for communicating the information necessary to facilitate access to his services and an understanding of his role.

The Correctional Investigator Canada's response: The Office is in complete

agreement with the Auditor General on the importance of ensuring that the Correctional Investigator's service is well known and accessible to all inmates.

In conjunction with our increased presence at the institutions mentioned in response to recommendation 33.30, during these visits we will be meeting with inmate committees and any active inmate groups for the purpose of providing information on our role and how to access our service.

We have initiated a review of the material on the Office currently contained in Correctional Service's induction package to ensure that it reasonably and accurately details both our role and the method of accessing our services. We will begin discussions with Correctional Service on the feasibility of designing information packages that address the illiteracy, learning disability and language challenges identified in the chapter.

The Office is currently, in consultation with various inmate committees, developing an information package that will be posted at each federal correctional institution.

### **Complaints Investigation**

33.38 The Act stipulates that the function of the Correctional Investigator is to conduct investigations into the problems of offenders. It has granted the Office full discretion over whether and how to conduct an investigation into these problems. Once the Correctional Investigator has decided to conduct an investigation, however, the Act is very specific on the requirement to conclude whether the problem exists or not (see Exhibit 33.3).

33.39 According to the legislation, a problem exists when a decision, act or omission of the Correctional Service staff is contrary to a law or an established policy or is unreasonable, unjust, oppressive or discriminatory; or when a discretionary power is exercised improperly (see Exhibit 33.3 for details).

In our opinion, this means that if the Correctional Investigator decides to intervene, he first needs to define the suspected problem. This is not only an important requirement for meeting the intent of the legislation but also a useful tool for identifying the root causes and developing remedies for systemic issues in the Correctional Service.

**33.40** It is not easy to determine, as the Act requires, whether a decision or act of Correctional Service personnel was contrary to law or policy, or was unreasonable, unjust or oppressive. It is reasonable then, to expect the

Correctional Investigator to have procedures and criteria to guide staff so that the Office has the ability to thoroughly and objectively investigate a wide spectrum of administrative actions.

### Significant improvement needed in procedures for carrying out investigations

33.41 Our detailed review of 180 randomly selected files revealed structural weaknesses in the investigative process of the Correctional Investigator. We found that few written policies and procedures exist to help the investigators determine whether there really is a

- 1. investigates inmate problems that are related to decisions, recommendations, acts or omissions of Correctional Service personnel.
- 2. after investigation, concludes whether the problem exists or not.
- 3. a problem exists if:
  - a) the decision, act or omission of Correctional Service personnel:
    - appears to have been contrary to law or an established policy;
    - was unreasonable, unjust, oppressive or improperly discriminatory;
    - was based on a law, practice or policy that is or may be unreasonable, unjust, oppressive or improperly discriminatory; or
    - was based wholly or partly on a mistake of law or fact, or
  - b) a discretionary power has been exercised:
    - for an improper purpose;
    - on irrelevant ground;
    - on the taking into account of irrelevant considerations; or
    - without reasons having been given.
- 4. may make recommendations that:
  - the Correctional Service give reasons to explain why the decision is made or the act or omission occurred;
  - refer the Correctional Service decision, act or omission to the appropriate authority for further consideration;
  - the Correctional Service decision be cancelled or varied;
  - the Correctional Service act or omission be rectified; or
  - the law, practice or policy be altered or reconsidered.
- shall inform the Minister if adequate action is not taken by the Correctional Service within a reasonable time.
- 6. shall maintain a program of communicating information to offenders concerning
  - a) the function of the Correctional Investigator;
  - b) the circumstances under which an investigation may be commenced

Exhibit 33.3

Legislative Scheme of the Correctional Investigator

We noted few written policies and procedures to help investigators determine whether there really is a problem and the nature of the supporting evidence required.

problem and what evidence is required to support that determination.

- 33.42 As noted earlier, many of the inmate contacts with the Office are inquiries for information or advice. The remaining cases are problems of various types that require different levels of intervention by the Correctional Investigator. During our file review, we noted that while investigators had classified each complaint by subject matter (such as transfer, inmate pay or temporary absence), the specific problem was not always identified.
- 33.43 Furthermore, we were not able to determine when and how the Office actually decided to investigate, and what the investigation entailed. This means that the time spent on a case can be more a reflection of the inmate's ability and persistence in communicating his case than of the relative importance or urgency of the case. Consequently, there is a risk that similar inmate problems are being handled inconsistently.
- 33.44 We also noted significant delays in responding to some inmates' complaints. We were told that some delays were caused by difficulties in getting timely responses from Correctional Service. However, many were due to inadequate procedures within the Office. For example, our review revealed that 24 percent of the outstanding files had not been flagged for future action by a given date to ensure a speedy conclusion. Further, in half of the cases that did have "bring forward" dates, those dates were 12 months old.
- 33.45 The lack of written policies and procedures results in weaknesses in the thoroughness and responsiveness of the investigative process. In addition, the absence of a systematic approach to identifying the problem behind the complaints leads to a lack of data that could help flag systemic issues. Issues so identified could then be the subject of

broad-based investigations to develop longer-term solutions.

33.46 The Correctional Investigator should establish appropriate policies and procedures to guide the investigators in carrying out their work. Specific guidelines should be issued to determine when investigations should take place and how they should be conducted to meet the intent of the Act.

The Correctional Investigator Canada's response: The Office accepts these recommendations and is in agreement with the Auditor General that steps be taken to provide greater consistency and efficiency both in identifying the point at which contacts or inquiries become a "problem" and in characterizing these "problems" in terms consistent with the provisions of the legislation. We also accepted that a clearer detailing of the areas of concern and the steps within our investigative process will assist in supporting both the identification of, and solutions to, systemic issues.

33.47 The Correctional Investigator should have in place procedures to support the identification of systemic issues.

The Correctional Investigator Canada's response: To guide the investigative process, the Office will develop written policies and procedures that reflect the requirements of the legislation and the operational realities of addressing inmate complaints.

### Disputes with Correctional Service Canada mean lost opportunities for improvements

33.48 In ombudsmanship, two basic principles are paramount. First, an ombudsman's recommendations are not binding on the organizations he or she oversees. This feature is critical because it keeps the oversight body at arms length and prevents it from becoming just another level within the organization's administration. Second, recommendations

made by an ombudsman must be feasible to implement and be based on evidence. The Act governing the Correctional Investigator reflects these principles.

33.49 The Correctional Investigator has at his disposal wide powers of investigation and unfettered access to Correctional Service information and facilities. Using these tools, he can establish the facts and present a case to Correctional Service management. Thus, the effectiveness of the Correctional Investigator reflects his ability to use these tools analytically and persuade Correctional Service to take reasonable corrective action.

33.50 We noted that some of the Office's recommendations have led, after many years of discussion, to substantive changes in certain policies and practices within Correctional Service Canada. On the issue of humanitarian temporary absences for inmates to attend funerals of family members, for example, the Correctional Service issued guidelines to clarify the intent of the policy. We also noted that Correctional Service has made some progress on such issues as

investigations of "use of force" and procedures used to discipline inmates. Further, the Correctional Investigator has participated in some of Correctional Service's reviews, such as those related to health care and the placement of offenders in administrative segregation.

However, it is clear from successive issues of the Office's annual reports that the Correctional Investigator and Correctional Service have had an adversarial relationship for a long time (see Exhibit 33.4). For the most part, their disputes centre on disagreement over Correctional Service's responses to what the Correctional Investigator has termed systemic issues, such as inmate pay, transfers and access to programming. In our opinion, it would be helpful if the two organizations could jointly establish a process for resolving and disposing of systemic issues so that opportunities to make lasting improvements to the system are not lost.

**33.52** When an adversarial relationship develops between an oversight agency and the government agency it oversees, it is conceivable that both bodies have played a role in its development. For example,

It would be helpful if
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and disposing of
systemic issues so
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improvements to the
system are not lost.

Exhibit 33.4

Continuing Disagreement between the Correctional Investigator and Correctional Service Canada

In 1992–93, the Correctional Investigator stated that the responses from Correctional Service's national headquarters were often "excessively delayed, defensive and non-committal".

In 1993–94, the Correctional Investigator noted that the majority of the issues detailed in the previous year's report had not been resolved.

In 1994, the Correctional Investigator invoked the applicable provision in section 180 of the Act and referred seven cases to the Solicitor General in an attempt to further pressure the Correctional Service to take action. The Commissioner of Correctional Service responded by reiterating the Service's position on each of the cases. Regarding the systemic issues, he argued that with such significantly different perspectives between the two agencies, it was very difficult to agree on what needed to be done next.

In response, the Correctional Investigator presented the following conclusion in his 1994–95 Annual Report: "The [Correctional Service] responses are defensive, display little if any appreciation of the history or significance of the issues at question, and provide at best a further string of promises of future action, with no indication as to expected results or how the results of these proposed actions will be measured or analyzed."

The Correctional Investigator further declared, in his 1995–96 Annual Report, "I have been singularly unsuccessful over the past few years, as evidenced by my previous Annual Reports, in causing a change in the Correctional Service's approach in dealing with matters raised by this Office."

Justice Arbour, in her inquiry into incidents at the Prison for Women, noted the Service's "demonstrated unwillingness" to accept the Correctional Investigator's conclusions. At the same time, based on our observations noted earlier, we believe that contributing factors include the overlap in the mandates of the two organizations and the structural weaknesses in the Office's investigative process.

33.53 To reduce the potential for disagreement, the Correctional Investigator should, in co-operation with Correctional Service, attempt to establish a more effective process for resolving and disposing of systemic issues.

The Correctional Investigator Canada's response: This Office and Correctional Service have commenced work on the development of a Memorandum of Understanding to clarify respective expectations in terms of content of communications, timeframe and methods of addressing disputes on facts, policy and law. It is hoped that this exercise will lead to a more effective process for resolving both individual and systemic areas of inmate complaint, and in turn, address some of the relationship issues identified in the Auditor General's Report.

It must be recognized, however, that even with the development of a more effective process, not all issues will be reasonably addressed. It must further be recognized. given the potential impact of administrative decisions within the correctional environment, that there is a need to ensure timely and responsive corrective action in instances of illegalities and unfairness. As such, this Office continues to support, as detailed in our Annual Report, the establishment of a tribunal with the authority both to compel compliance with the legislation and policy governing the administration of the sentence and to redress the adverse effects of non-compliance.

Referral to the tribunal would occur in instances where this Office and Correctional Service have failed, within the provision of the existing legislation, to reach resolution on a significant issue related to the liberties and rights of inmates. As such, a tribunal would support and complement the function of this Office in ensuring that areas of inmate concern are decided on in an objective and timely fashion consistent with the provisions of the legislation.

### **Reporting Results**

Database does not yield reliable statistics

33.54 The Office has a Complaint Tracking System that forms the database it needs to manage its operations and to measure and report its performance. From this database, the Correctional Investigator compiles statistics on workload and results, which are subsequently presented in his annual report to Parliament.

33.55 We reviewed the accuracy of data in a sample of cases to assess the reliability of the database. We found that the classification of cases according to their ultimate disposition was not consistent. For example, investigators had defined the term "resolved" and "not justified" differently. Our review also indicated that approximately 50 percent of the sampled cases had been classified and reported inaccurately. For example, a single complaint can be concluded initially as "premature" and counted once in the initial stage, and then be counted again after further intervention. These inaccuracies have occurred because the Correctional Investigator has not clearly defined what constitutes a complaint, what constitutes an inmate problem and precisely what each stage of the complaint-handling process entails. The cumulative effect of these deficiencies compromises the Correctional Investigator's ability to provide useful information both for management

purposes and for his annual report to Parliament.

33.56 The legislation requires the Correctional Investigator to submit a report annually to Parliament on the work of his Office. To make the information in it more meaningful, the Office needs to include a description of its objectives, the strategies used to attain those objectives, and the results achieved toward meeting the objectives.

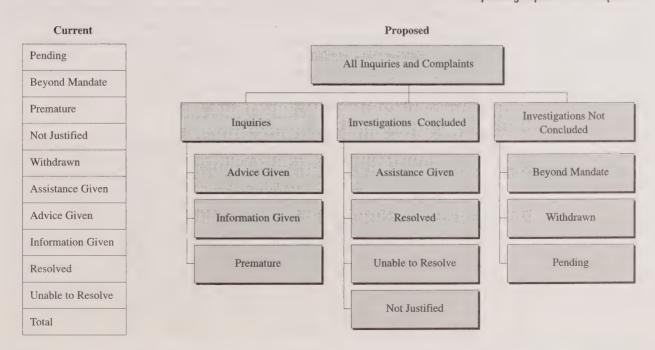
33.57 We reviewed the Office's previous annual reports, particularly those issued after the enactment of its legislation. A section of each report has provided statistics showing, for example, the number of cases received, by category and by institution, the number of interviews conducted, and the disposition of the cases. However, because the integrity of the database is questionable, we conclude that some of the statistics in the annual reports are not reliable.

33.58 We also believe that the results of the Office could be measured in a more meaningful way. For example, the statistics on the disposition of complaints could be separated from statistics on inquiries (see Exhibit 33.5). Further, the Office could report the results of its work in terms of the types of problems it has investigated and the extent to which they exist — such as the number of instances where it determined that an act or decision by Correctional Service was contrary to law — instead of referring only to the subject matter such as visits, case preparation, health care and so on.

33.59 We also noted that annual reports of other ombudsman offices have included indicators of efficiency, responsiveness, and effectiveness (see Exhibit 33.6). Further, their annual reports are generally more balanced in that they provide information about the operating constraints on the government organizations they oversee and on the progress made over the years. In our

Exhibit 33.5

#### **Separating Inquiries and Complaints**



opinion, including some of this information in the Correctional Investigator's annual report would improve the report's usefulness to Parliament.

33.60 The Correctional Investigator should review the quality and consistency of input to the Case Tracking System to improve the reliability of the information the system produces.

The Correctional Investigator Canada's response: The Office accepts both recommendations.

With respect to the quality and consistency of the input into the existing system, further staff training has been undertaken to again clarify the categories of complaints and the meaning of the dispositions. In addition, random quality control checks on the data will occur on a quarterly basis.

33.61 The Correctional Investigator should report results in a more meaningful way, such as separating complaints and inquiries in reporting disposition statistics, and developing some additional indicators of results for inclusion in the annual report.

The Correctional Investigator Canada's response: With respect to the improved reporting of results and the development of additional indicators of those results the Office, in consultation with other

ombudsman operations at the federal and provincial level, will initiate a review to identify what information is required from both a management and reporting perspective and the best method of capturing that information, given resource and operational realities.

### Conclusion

33.62 The objective of this audit was to assess whether or not the Office of the Correctional Investigator has been able to organize itself effectively to discharge its mandate. We noted that the Office started with a loosely defined mandate under the Inquiry Act in 1973. It has since accumulated a set of practices that had not been subjected to any kind of review prior to our audit. We found that while these practices are often helpful in resolving individual complaints, they are not conducive to efficient and consistent handling of cases and have contributed to its adversarial relationship with Correctional Service Canada.

33.63 The Office operates in an environment where demand for its service is incessant and its relationship with Correctional Service Canada needs careful balancing. Our audit has led us to conclude that the Office needs to improve its strategies, policies and practices in order to effectively manage its workload, communicate with inmates, investigate inmates' problems thoroughly, and

#### Exhibit 33.6

Some Useful Indicators of Ombudsman Performance

- fairness indicators (for example, percentage of complaints unsubstantiated, total and by category)
- responsiveness indicators (for example, case turnaround time)
- effectiveness indicators (for example, percentage and number of findings and recommendations accepted by the department and improvements made to departmental policies and practices)
- level of client satisfaction (through various client feedback mechanisms)
- measures of its own compliance with standards (such as a fairness checklist)
- multi-year comparison of some or all indicators shown above
- case studies to exemplify typical and key problems encountered by inmates
- comments on underlying causes and on systemic weaknesses

maintain a balanced relationship with Correctional Service.

33.64 Although we call attention to a number of problems in the organization, we would emphasize that the Office plays an important role in ensuring fairness for those serving sentences and in reducing the potential for unrest in Canada's prisons. The problems we have noted can and should be fixed so that the Office of the Correctional Investigator can better play its role within the Canadian criminal justice system.

Correctional Investigator's general comments: Chapter 33 of the Auditor General's Report provides both a detailing of this Office's operations and an overview on the role of an ombudsman. The chapter emphasizes the importance of our role as an ombudsman for federal inmates and offers a series of practical and well-focussed recommendations that will assist this Office in better fulfilling its mandate within the Canadian criminal justice system.

There are two factors that, although beyond the scope of the audit, we believe need to be noted in reviewing the chapter's observations and recommendations. First is the public reporting feature common to all ombudsmen. It is public reporting, especially in areas where resolution with the government agency has not been achieved, that provides the ombudsmen with a recourse to ministerial. parliamentary and public consideration of their findings and recommendations. This external consideration of issues, given the non-binding aspect of the recommendations, is central to an effective ombudsman operation. This matter is raised to emphasize that the responsibility for the resolution of issues, especially within an environment like corrections, does not rest solely with the government agency and the ombudsman.

Second is the Office's resource base. The Auditor General notes that this is a small agency with a small budget. The chapter further notes that the demand for our services is incessant and that our areas of responsibility expanded with the introduction of the Corrections and Conditional Release Act in 1992. In addition, both the inmate population and the number of federal correctional facilities have increased measurably during this time period. There has been no adjustment of our resource base since 1992.



#### **About the Audit**

#### **Objective**

The objective of our audit was to determine whether the Office of the Correctional Investigator has adequately organized itself to fully carry out its mandate. We focussed on the practices that the Office has established to fulfil its mandate and on the way it manages its operations, measures its performance and reports its results.

#### Scope

The scope of our audit included all aspects of the Correctional Investigator's operations, from the intake of complaints to informing Parliament of the results. It did not include a review of Correctional Service, other than the Office's dealing with the Service in the complaint process.

#### Criteria

We expected to find that the Office:

- has an appropriate accountability framework;
- has mechanisms to facilitate the discharge of its mandate;
- manages its operations efficiently; and
- has in place systems and procedures to measure and report its performance.

#### **Audit Team**

Jayne Hinchliff-Milne Patricia MacDonald Jocelyne Therrien

For information, please contact Robert W. Chen, the responsible auditor.

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Report of the Auditor General of Canada to the House of Commons

Chapter 34 RCMP Public Complaints Commission

December 1997



## Report of the Auditor General of Canada to the House of Commons

Chapter 34 RCMP Public Complaints Commission

December 1997

This December 1997 Report comprises 16 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, October and December 1997 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.



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## Chapter 34

RCMP Public Complaints
Commission

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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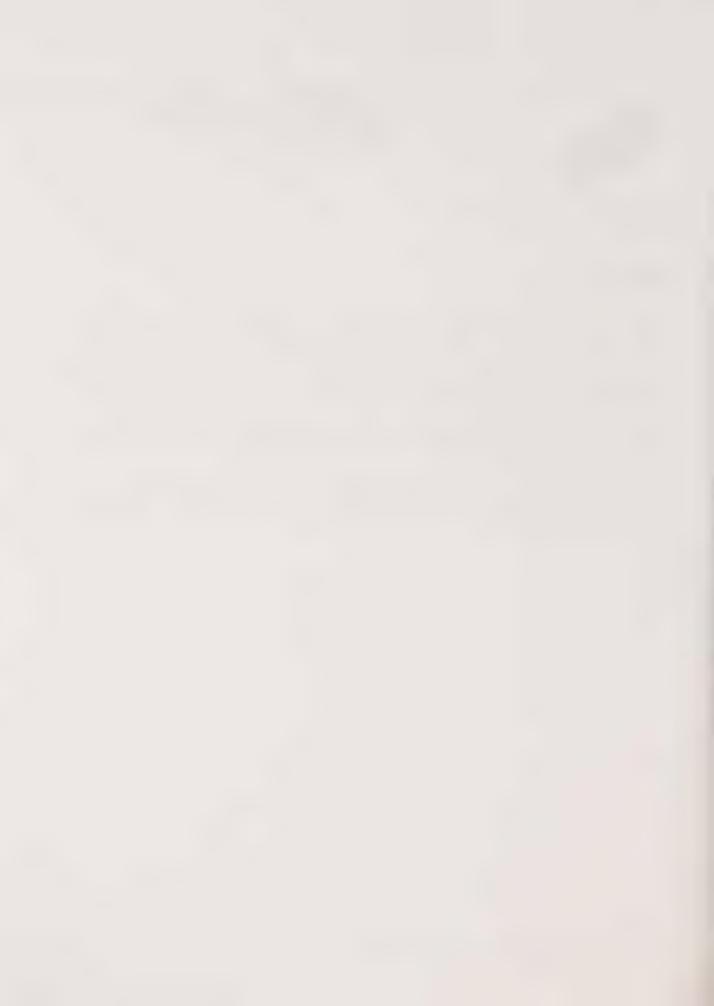


Assistant Auditor General: Maria Barrados Responsible Auditor: Robert W. Chen

## **RCMP Public Complaints Commission**

#### **Main Points**

- 34.1 The RCMP Public Complaints Commission is responsible for reviewing public complaints about the conduct of members of the RCMP. Although its budget is small (\$3.5 million), the Commission can, through its reviews, enhance the transparency of the complaint process and help the RCMP to improve its policing practices.
- 34.2 Although the Commission has articulated the need to develop and implement a communications strategy, it has yet to finalize its plan for informing Canadians about their right to request a review if they are not satisfied with the RCMP's disposition of their complaints.
- 34.3 The Commission's handling of complaint reviews and public hearings is slow. It needs to improve the way it works by streamlining the review process and providing appropriate training to Commission members who are responsible for conducting public hearings.
- 34.4 The Commission also needs to improve its performance measures. Although useful statistics are provided in its annual report, they are often incomplete or inconsistent. The Commission needs to renew its effort to provide a fuller picture that demonstrates both its contribution to the public complaints process and the overall effectiveness of that process.



#### Introduction

- 34.5 The RCMP is Canada's federal police force. It is also contracted to serve as the police force for all provinces (except Ontario and Quebec), the two territories, and nearly 200 municipalities. About 50 percent of its members are engaged in provincial and municipal policing. These activities bring them into contact with the public more often than does their federal law enforcement work. It is in these policing activities, then, that members of the Force are more likely to be the subject of complaints.
- 34.6 The RCMP Public Complaints Commission is an important institution in our democratic system. It has been established by Parliament to ensure that members of the RCMP, who are given special authority and power under the law, are properly accountable to the public for their conduct.
- 34.7 Before September 1988, anyone wishing to complain about the conduct of a member of the RCMP had to lodge the complaint with the Force itself. If not satisfied with the RCMP's disposition of the complaint, the complainant's only recourse was to seek redress through the courts.
- 34.8 Two major reports - the Marin Report (1974) and the McDonald Report (1977) - identified as a weakness the lack of an independent authority to review the actions of the RCMP in handling public complaints. The need for independent review was apparent given the perceived difficulties of having the RCMP itself investigate allegations of improper conduct by its own members. The Force could not be both the supervisor of its members and the final arbiter of complaints against them. Both reports suggested that complainants and RCMP members involved in complaints were entitled to the unqualified confidence in the RCMP that could be provided by an external body with the power to review

allegations of improper conduct by members of the Force.

34.9 In the 1970s, a number of provincial governments had established police commissions to oversee the handling of public complaints about police conduct. That move was based on the principle that the special power of the police over members of the public needs to be balanced with the impartial and fair review of complaints by an independent, civilian body. The civilian body would thereby strengthen the accountability of the police force to the community, which would strengthen public confidence and, ultimately, improve policing practices.

#### The focus of the Commission's mandate is independent review

- 34.10 The RCMP Public Complaints Commission was established by the *RCMP Act* and became operational on 30 September 1988. It was created to receive complaints and provide a process for the external and independent review, investigation and hearing of complaints about the conduct of RCMP members in the performance of their duties.
- 34.11 The complaints process consists of three stages: receipt of complaints and investigation by the RCMP; review and investigation, if necessary, by the Commission, if the complainant is not satisfied with the RCMP's disposition of the complaint; and a hearing by the Commission if the Chairman concludes that a hearing is desirable.
- 34.12 Members of the public can initiate complaints by contacting the Commission; or a provincial authority responsible for receiving and investigating complaints about the police; or the RCMP itself. A complaint received by the Commission or by provincial authorities is forwarded to the RCMP, which is responsible for the initial investigation of all complaints. If the complainant is not satisfied upon notification of the RCMP disposition, he or she may refer it to the Commission for review. The workload of

If the complainant is not satisfied upon notification of the RCMP disposition, he or she may refer the complaint to the Commission for review.

the Commission for the last three fiscal years, excluding public hearings, is shown in Exhibit 34.1.

34.13 In addition to reviewing complaints referred to him, the Chairman of the Commission has discretion under the Act to initiate his own complaint, if he believes there are reasonable grounds for investigation. The legislation also gives the Chairman discretion, in the "public interest", to investigate any complaint or to institute a hearing, whether or not the RCMP has handled the complaint.

After a review or a hearing, a 34.14 report is prepared setting out the Commission's findings, and its recommendations when it is not satisfied with the RCMP's disposition. The report is sent to both the Commissioner of the RCMP and the Solicitor General. The Commissioner must review the complaint in light of the report and notify the Commission and the Solicitor General as to what further action will be taken. If the Commissioner decides not to act on the Commission's report, he must provide the Commission and the Solicitor General with reasons.

34.15 The Chairman of the Commission then prepares a final report and sends it to the complainant, the member of the RCMP whose conduct is in question, the Commissioner of the RCMP and the Solicitor General. On occasion, a party to

a complaint will seek further action through the courts, notify the media, or bring the matter to the attention of the Solicitor General or Parliament.

**34.16** If the Chairman agrees with the way the RCMP has disposed of the complaint, a "satisfied" report is sent to the complainant, the involved member, the Commissioner and the Solicitor General.

#### The Commission reviews a variety of public complaints

34.17 While each complaint is important to the individual complainant, the Commission reviews complaints of varying degrees of seriousness. There have been complaints about RCMP members having a "poor attitude" being curt or discourteous; others have alleged that the RCMP used excessive force or that the complainant was assaulted while in police custody. For example, a man complained that a member used excessive force during his arrest and when putting him into a cell at the RCMP detachment. The member stated that the man had been drinking and had become confrontational. After the RCMP disposed of the complaint, the complainant referred the case to the Commission for review. The Commission found that while the officer had used reasonable force during the arrest, the use of force at the detachment was improper.

Exhibit 34.1

Number of Complaints and Requests
Received by the Commission

	Complaints Received by the Commission	Complaints Received by the RCMP	% Complaints Received by the Commission	Requests to the Commission for Review
1994–95	919	2,212	41.5%	231
1995–96	1,018	2,592	39.3%	308
1996–97	1,002	2,384	42.0%	299

Source: The Commission's Annual Reports

The Commission recommended that the member apologize to the complainant.

- 34.18 Sometimes, however, complaints may link the misconduct of individual members to weaknesses of a systemic nature, such as a lack of training or inadequate policy. In these cases, the Commission may recommend that the RCMP address the systemic weaknesses. While the Commission's recommendations are not binding, the RCMP has accepted and implemented many of them in order to improve its policing practices.
- 34.19 For example, a man complained that a member had not conducted an adequate investigation into the alleged sexual assault of his daughter. The Commission recommended that the member involved in the complaint receive further investigative training and that a divisional policy be developed, governing the videotaping of child witnesses in sexual assault complaints. In response, the RCMP has committed itself to rewriting its national policy in this area.
- 34.20 As this example illustrates, the relationship between the Commission and the RCMP can lead to positive results. We were informed that it can also create tensions: members of the Force sometimes believe that the Commission's reviews second-guess their work and prevent them from getting on with their job of protecting Canadians. RCMP management has occasionally perceived the Commission as interfering with its internal management. However, external review can give rise to a healthy "creative tension" that can lead to greater police accountability to the public and to improvements in policing services.

#### Organization and resources

**34.21** The Commission has a budget of \$3.5 million, of which approximately \$2 million represents salaries and benefits. Other than salaries, the largest operating expense is for professional and special services.

- 34.22 The Commission's Chairman is appointed by order of the Governor in Council as a full-time member. As well, part-time members are appointed to represent the provinces and the two territories policed by the RCMP. The Commission is supported by 33 full-time staff in three offices.
- **34.23** The Commission's head office is located in Ottawa. It has regional offices in Vancouver and Edmonton. Although complaints from the public are received in the three offices, they are all reviewed by the Ottawa office.

#### Focus of the audit

34.24 Our aim was to determine whether the RCMP Public Complaints Commission has adequately organized itself to discharge its mandate. We focussed our examination on the Commission's systems and practices for carrying out its mandate, managing its operations, measuring its performance and reporting its results. Details on our audit scope and criteria can be found at the end of the chapter, in About the Audit.

"creative tension" that can lead to greater police accountability to the public and to improvements in policing services.

External review can

give rise to a healthy

### Observations and Recommendations

#### **Mandate and Planning**

The Commission has established systems and practices to fulfil its mandate

- **34.25** The *RCMP Act* sets out clearly the mandate of the Commission and delineates the respective roles and responsibilities of the Commission and the RCMP in the public complaints process.
- 34.26 During our audit, we interviewed senior management and operational personnel. We also reviewed policy and procedural manuals, minutes of the Management Committee, operational plans and budgets, annual reports and other relevant documents, such as the

We noted that over the years the Commission and the RCMP have resolved a number of important mandate and legal issues, either through the courts or by administrative agreements.

The Commission still does not have a communications strategy.

Although the
Commission has
generally established
systems and practices
to fulfil its mandate, it
does not have in place
an approach to
planning that directs
its efforts to priority
areas.

Mission Statement, to assess the extent to which the Commission has fulfilled its mandate.

34.27 We noted that over the years the Commission and the RCMP have resolved a number of important mandate and legal issues, either through the courts or by administrative agreements. Two key issues remain to be resolved — disclosure to complainants and the Commission of the specific discipline imposed on RCMP members for an act of misconduct, and publication of the Commission's final reports. The Commission is pursuing the resolution of these issues.

34.28 The Commission's systems and practices are described in its various manuals. For example, the Complaints Policy and Procedures Manual clearly delineates the roles and responsibilities of the Chairman and his staff with respect to the complaints procedures and review process.

34.29 The Commission's responsibilities include informing the public of its existence and function, receiving complaints, reviewing RCMP dispositions referred to it by dissatisfied complainants, initiating and conducting public hearings, and making recommendations to effect positive changes in RCMP policing practices.

Although the Commission has 34.30 generally established systems and practices to fulfil its mandate, it does not have in place an approach to planning that directs its efforts to priority areas. Our review revealed that the Commission has set out a mission statement and defined its goals and priorities in its planning documents. Plans used for internal purposes are the same as those set out in Part III of the Estimates. In areas requiring specific attention, more detailed action plans are required. During the course of our audit, we identified two areas for which no plans with specific actions had been developed to address initiatives set

out in Part III — receipt and review of complaints in a timely fashion, and improving communications to inform the public about the Commission's existence and mandate.

#### A communications strategy is needed

From the beginning of its 34.31 operation, the Commission recognized that "the right to a review is of no value to a person who is not aware of that right." The Commission has conducted several studies to identify communications factors that need to be addressed. One study found that the use of RCMP at the beginning of its name invites, and indeed has created, a public perception that the Commission is part of the RCMP rather than an independent body. Its name in French — la Commission des plaintes du public contre la Gendarmerie royale du Canada — has not caused such difficulty. Another study found that it is confusing for residents of a province to have two different public complaints systems and two different external review bodies one for the RCMP and one for local police forces. A third study pointed out the diversity of the Commission's constituency and hence the corresponding need for a multi-pronged communications approach.

**34.32** However, after several attempts over the last five years, the Commission still does not have a communications strategy that defines specific actions to address these concerns.

34.33 A 1995 study conducted for the Commission by Statistics Canada revealed that while 70 percent of the complainants surveyed were aware that the Commission was a separate organization, only 21 percent realized that it was independent of the RCMP. We believe that the failure to develop and implement a communications strategy to inform the public about its role as an independent, civilian oversight body is an important factor in this misconception.

34.34 The Commission should develop a communications strategy to improve public awareness of its existence and mandate as well as its independence from the RCMP.

Commission's response: The RCMP Public Complaints Commission is in full agreement with this recommendation. The Commission has developed three draft communications plans and strategies over the past five years but has not yet approved a plan and strategy. The Commission undertakes to produce a communications plan and strategy by March 31, 1999.

It should be recognized that the term of the Commission's Chairman for the past five years has expired and that it will take the new Chairman some time to become fully cognizant of the operations and activities of the Commission. As a result, some time must be provided to allow for this familiarization process.

#### **Review of Public Complaints**

#### The review process is slow

34.35 The Commission has a Complaints Policy and Procedures Manual. This is an important tool to ensure that all complaints referred to the Commission for review are handled in a fair and consistent manner. Our examination of selected files and observations of the complaints review process indicated that the Commission has, indeed, handled complaints in accordance with the prescribed procedures (see paragraph 34.11).

34.36 The 1995 Statistics Canada survey revealed that 75 percent of complainants and 69 percent of RCMP members surveyed said the Commission's reviews took too long. In its annual report, the Commission reported that in 1995–96 the average turnaround time to complete a complaint review, in cases where the Commission agreed with the RCMP's disposition, was about 160 days. In cases

where it disagreed with the RCMP, the turnaround was about 340 days. Both results exceeded the Commission's own objective of a 90-day turnaround. The Commission has since changed this target to a 120-day turnaround.

34.37 In the past when the volume of complaints requiring review increased and the turnaround time increased in turn, additional staff were brought in on a temporary basis. This improved the Commission's turnaround time but did not eliminate the backlog. Given the lack of a strategy and supporting actions to improve the situation under the current approach, backlogs are again increasing. A recent internal report also indicated that the Commission's backlog had increased to about 400 cases, equivalent to more than its yearly workload. Our audit identified opportunities to streamline the review process and improve turnaround time.

For example, the quality control mechanism that the Commission uses could be simplified and streamlined. Because the Chairman signs all Commission reports, each report goes through a multitude of quality controls, including the Complaints Review Committee. Consequently, the process is time-consuming. An internal audit report highlighted this weakness and made certain recommendations that the Commission has implemented to simplify and streamline the function of its Complaints Review Committee. However, we observed that the Committee continues to spend a large amount of time reviewing the quality of each report and debating issues that have been settled previously in similar cases.

34.39 The Commission has recently installed a report retrieval system that contains all details of each complaint it has reviewed, including findings and recommendations. While the system can be used to access "precedent" cases, the Commission's staff have yet to be trained to use it to ensure that similar complaints are handled in a consistent way. This also

Our examination of selected files and observations of the complaints review process indicated that the Commission has, indeed, handled complaints in accordance with the prescribed procedures.

suggests a missed opportunity to streamline the process and shorten the time required to complete reviews.

34.40 The Commission should investigate ways and means of improving its turnaround times, including streamlining its review process and training its staff in the use of the report retrieval system.

Commission's response: The RCMP Public Complaints Commission agrees with the recommendation. While the Commission has been aware that its process can be slow, it has, over the years, continually been working to speed up the process. In the Commission's Part III Estimates for 1997–1998, the Commission indicated its concern about turnaround time in the review of complaints and undertook to reduce the time it takes to process final reports by 30 days over the next three fiscal years. The Commission undertakes to continue this initiative on a year-to-year basis so as to further reduce the turnaround time.

In respect of the report retrieval system, the Commission undertakes to provide instruction on its use for the newer staff at the Commission and to provide a refresher course to staff who have been with the Commission for a longer period of time.

#### Public hearings in the "public interest" require terms of reference

34.41 The Chairman has the legislative authority to institute a public hearing either as part of a regular review or in the "public interest". The Commission told us that a hearing that is part of a regular review generally focusses on a specific complaint. However, a hearing in the public interest can cover issues that underlie or are related to the misconduct in question, in addition to the specific complaint.

**34.42** Since its inception in 1988, the Commission has held 16 hearings, 11 of which were in the public interest. Public

hearings provide a window into the RCMP's operations and an opportunity to strengthen accountability to the community. This is in keeping with the goal of independent, civilian oversight. However, hearings are time-consuming and costly. The Commission's longest public hearing took almost four years to complete, and the most expensive one, to date, has cost the Commission more than \$600,000.

34.43 The RCMP, which is always a party to hearings, has been critical of the way public interest hearings have been conducted. In its comments on a recent hearing, the RCMP said that the Commission's hearing panel "allowed irrelevant testimony, irrelevant witnesses, unsupported allegations of unrelated incidents and discussions to be presented." Our interviews with panel members, counsel and Commission staff revealed similar concerns.

34.44 While it has been criticized for "taking too much time to complete a hearing", the Commission needs to continue hearing important issues of public interest in order to fulfil its mandate. However, we believe that to do so the Commission needs to significantly improve the way it carries out public hearings, both by prescribing clear and precise terms of reference for each hearing and by providing its members with training in conducting hearings.

34.45 As we have noted, the Chairman has the power to call hearings in the public interest. The Commission's position is that the decision to call a public hearing will be based on the Chairman's judgment after careful consideration of the case. We noted that the Chairman's reasons for calling hearings have not been recorded and routinely provided to hearing panel members. As a result, public hearings have been initiated and carried out without terms of reference or criteria establishing the public interest to be considered. Our review of hearing files

The Commission needs to significantly improve the way it carries out public hearings.

confirmed the absence of terms of reference. Hearing panel members and other parties to hearings have also indicated that they are concerned about this issue.

34.46 A working group established in 1995 to review the *RCMP Act* proposed an amendment that would require the Chairman to identify the public interest concerns when instituting a public hearing. It pointed out that such a requirement would be helpful to all parties in preparing for hearings. A more focussed hearing would be less time-consuming and therefore less costly. While waiting for proposed legislative changes, the Chairman has the power to consider administrative measures to set out the terms of reference for hearings.

34.47 The Chairman of the Commission should set out clear and precise terms of reference for hearings in the public interest.

Commission's response: This recommendation [had to] be discussed by the members of the Commission in order to prepare a response. That discussion [was] to be held October 29 to 31, 1997. A response to this recommendation [was] then [to] be prepared by the Commission.

#### Commission members need training in conducting public hearings

34.48 Commission members are appointed by order of the Governor in Council. The Commission has no formal input to the selection of members. We note that most members have a legal education, but not necessarily experience in conducting public hearings. To conduct and manage public hearings effectively, they need a good knowledge of administrative law and a sound understanding of rules and procedures, given that these proceedings often involve many interested parties and complex legal arguments.

34.49 Despite this, members of the Commission who may be assigned to public hearings receive no formal training in conducting these hearings. Although members have indicated that they need training, the Commission has cited the lack of funds as a reason for not providing it.

34.50 In recent years, demand has been increasing for appropriate training for Governor in Council appointees who are responsible for conducting public hearings. As a result, the federal government has established a three-phase training program to provide tribunal members with a sufficient level of knowledge and skills to conduct public hearings. Although the Commission is aware of this training program, and its legal counsel is one of the instructors, no members have attended it.

34.51 The Commission should ensure that its members receive the appropriate training before they are assigned responsibility for conducting public hearings.

Commission's response: This recommendation [had to] be discussed by the members of the Commission in order to prepare a response. That discussion [was] to be held October 29 to 31, 1997. A response to this recommendation [was] then [to] be prepared by the Commission.

#### **Measuring and Reporting Results**

34.52 The Commission has put in place a Complaints Tracking Database, which contains, among other things, specific descriptions and key dates of every complaint that comes to the Commission for review. The Commission can use the database to determine its workload volume and calculate its turnaround time for reviews. While these are useful statistics, we have a number of concerns about the meaning and accuracy of these measures of results.

Members of the Commission who may be assigned to public hearings receive no formal training in conducting these hearings.

#### The Commission needs to improve the measurement of its turnaround time

Our review of the database itself revealed that many key dates in the review process had either not been entered or had been entered incorrectly. The published turnaround time differed from figures in the Commission's working papers. There was no explanation for this inconsistency. As a result, statistics on turnaround time drawn from the database are of uncertain reliability. We are concerned that the Commission has not approached its measurement of turnaround time from the perspective of complainants. The Commission counts only the time from the day it receives all relevant material from the RCMP to the day on which the Chairman issues his final report — less any time outside its control, such as time spent waiting for the RCMP Commissioner's responses to the interim reports.

34.54 While this figure may be useful for the Commission's internal purposes, it is not a reasonable measure from the perspective of complainants. For them, the clock begins to tick when they ask the Commission to review their cases, if not when they lodge the complaints initially. Their satisfaction, or lack of it, depends on their judgment about the overall length of time taken to get a resolution. They are not interested in whether any delays are caused by the Commission or by the RCMP.

34.55 Our present analysis of the data from the database indicates that the amount of time not included in the Commission's current definition of turnaround time is significant. Including it would add up to another 90 days to the present average, which still excludes the time between the date when the complaint is lodged and the date when the Commission is asked to review it.

34.56 Furthermore, we found that the database has not been used to produce

routine reports, such as turnaround time for its reviews and the volume of its backlog. When the Commission needs these reports, it has to make a special effort to extract data and tabulate the statistics.

#### 34.57 The Commission should:

- improve the quality of data in its Complaints Tracking Database;
- develop better measures of the turnaround time for complaint reviews; and
- strengthen the report-generating capacity of the Complaints Tracking Database.

Commission's response: The Commission is in complete accord with this recommendation. However, it would like to point out that over the past ten months there has been a high turnover in the operations branch of the Commission including both officers and support staff. The reliability of the Complaints Tracking Database (CTD) has been the unfortunate victim of this situation. As the personnel situation becomes more stable, the Commission will be making every effort to ensure that the information in the CTD is more reliable.

The Commission also undertakes to establish a measure more relevant to both complainants and RCMP members for calculating the turnaround time for complaint reviews. However, it should be noted that when the complainant and the RCMP member(s) receive the Commission's final report, the following dates are always provided to them:

- the date the complaint was received;
- the date of the RCMP's letter of disposition;
- the date the request for review was received by the Commission; and
- the date the relevant material was received by the Commission.

While there are several existing reports that have been created to report specifically on the time spent in each stage by each request for review, in the last year or so these reports have not been generated on a regular basis. The Commission undertakes to generate existing reports on a more regular basis, as well as to create other reports that will provide regular information on the backlog of the Commission, among other things.

#### A consistent approach is essential in reporting results

- 34.58 According to the *RCMP Act*, the Commission has two levels of accountability. It is required by legislation to inform the parties to each complaint of the result of its review. On a summary basis, it is also required to submit to Parliament, through the Solicitor General, an annual report on its activities.
- 34.59 During our audit, we noted that the Commission has established procedures to ensure that the Chairman's reports are sent to parties to the complaint at each stage of the review process, as required by legislation. The Commission has also submitted its report to Parliament annually. All reports are similar in content and structure. Each provides a summary of the Commission's activities, details of some sample complaints together with review findings and recommendations, and a general discussion of the effect of the Commission's work. In our opinion, these descriptive sections of the report are informative, and useful for accountability.
- 34.60 The Commission has also included some statistical details in its annual reports to describe the results of its work. Although these statistics provide additional concrete information for accountability purposes, we have concerns about the reliability of the information and usefulness of the results provided.

- 34.61 The Commission measures its impact on the RCMP in terms of the extent to which its recommendations have been accepted. It has reported that the Force has accepted about 80 percent of its recommendations. Although we have observed changes in RCMP policies and procedures as a result of the Commission's recommendations, we could not confirm all the statistics in this area. As reported in paragraph 34.53, measures of turnaround time drawn from the Complaints Tracking Database are of uncertain reliability.
- We were informed that a 34.62 complaint may contain one or more allegations. Each allegation is examined on its own merit. In disposing of a complaint, the RCMP may support one allegation in a complaint but may not support another. At the same time, in reviewing a complaint the Commission may be satisfied with the RCMP's disposition of one allegation, while it may not be satisfied with another. Therefore, a common approach or framework for reporting the outcomes of RCMP investigations and Commission reviews is essential.
- 34.63 The RCMP and the Commission have been using a common reporting approach since 1993 for classifying allegations. We found that the RCMP is able to provide statistics on its disposition of all allegations it has investigated (see Exhibit 34.2). However, the Commission does not report the results of its reviews of allegations. It reports only on its review of complaints, which may contain any number of allegations. Consequently, it is difficult to assess the contribution of the Commission in adding fairness to the overall process (that is, how often the Commission found an allegation to be substantiated that the RCMP had not) and in identifying systemic problems in RCMP policing practices (that is, the type of allegation most often found by the Commission to be substantiated).
- **34.64** Parliament needs fair and reliable information in order to assess the overall

It is difficult to assess the contribution of the Commission in adding fairness to the overall process and in identifying systemic problems in RCMP policing practices. results and effectiveness of the public complaints process that it established in 1988.

34.65 For its report to Parliament the Commission should improve the reliability of the information and provide more information on the results of its handling of allegations.

Commission's response: The Commission supports this recommendation. In fact, steps have already been taken to collect this information within the Commission. The Commission will consider the development of other reports on its review of the RCMP disposition of public complaints so as to provide more

information that could help it to assess the contribution of the Commission in the public complaints area.

#### Conclusion

34.66 We found that from the time it first began operations in September 1988, the Commission had established systems and practices to fulfil its mandate. However, we observed a number of areas in its management practices that need to be strengthened. The Commission needs a communications strategy to improve public awareness of its existence, mandate and independence. It also needs to develop specific action plans to address the issues we identified in its processes for

Exhibit 34.2

Disposition of Allegations Investigated by the RCMP

	1994 RCMP Statistics			
Allegation Classification	Total	Withdrawn	Unsupported	Supported
Improper Attitude	915	51	653	211
Improper Use of Force	560	35	501	24
Improper Use of Firearms	24	1	23	0
Irregularity in Procedure	442	30	356	56
Driving Irregularity	86	2	59	25
Neglect of Duty	715	38	591	86
Statutory Offences	240	5	216	19
Mishandling of Property	66	3	54	9
Irregularity - Evidence	51	1	48	2
Oppressive Conduct	498	22	435	41
Improper Arrest	216	17	190	9
Improper Person/Vehicle Search	58	4	47	7
Improper Search of Premises	89	15	59	15
Policy	72	6	51	15
Equipment	25	1	17	7
Service	176	15	142	19
Total	4,233	246	3,442	545
Percentage	* * *	5.8%	81.3%	12.9%

Source: Internal Affairs Branch, RCMP

reviews and public hearings, in order to respond to parties to complaints in a more timely manner. Finally, it needs to improve measures of performance in order to provide fair and reliable information on the results of its activities.

Commission's comments: The chapter provides a clear outline of the operations of the RCMP Public Complaints Commission. It recognizes the complexity of the process for the receipt and review of complaints as set out in Part VII of the RCMP Act. It also indicates the importance of an independent civilian oversight of the handling of public complaints as a means of ensuring the accountability of the police to the community. The chapter illustrates the range of police conduct that might be the subject of a public complaint and that complaints might deal with weaknesses of a systemic nature, as well as the individual conduct of members of the RCMP. The fact that a "creative tension" might exist between the RCMP and the Commission is seen as a healthy situation that can be expected to exist in a civilian oversight relationship.

The chapter provides pertinent and practical recommendations to improve the strategic planning of the Commission, as well as the gathering and reporting of information on the complaint review process and its results. Some of its

recommendations raise issues about the conduct of public hearings of the Commission and the training of Commission members in respect of holding such hearings. The RCMP Act is abundantly clear in matters having to be addressed by members of the Commission as defined in subsection 45.29(1). According to section 45.33, it is the Commission that makes the rules respecting the manner of dealing with matters before it. Therefore, it is the Commission members who must consider those recommendations as they relate to public hearings and training. As a result, these issues [were] put on the agenda for the Annual General Meeting of the Commission ... held October 29 to 31, 1997.

As is mentioned in the Introduction to the chapter, the Commission is very small and has limited resources. As its main activity is the review of complaints that have been investigated and disposed of by the RCMP, most of its finances are devoted to that activity. The costs involved in carrying out some of the recommendations in the chapter could put a strain on the financial resources involved in carrying out the review activity, particularly the training of the members. Nevertheless, the Commission will do all it can to respond in an active manner to the recommendations in the chapter.



#### **About the Audit**

#### **Objective**

The objective of our audit was to determine whether the RCMP Public Complaints Commission has adequately organized itself to fully carry out its mandate. We focussed on the practices the Commission has established to fulfil its mandate, and on the way it manages its operations, measures its performance and reports its results.

#### **Scope**

The scope of our audit included all aspects of the Commission's operations, from receiving complaints to informing Parliament of the results. It did not include a review of the RCMP, other than the Commission's dealings with the RCMP in the public complaint process.

#### **Audit Criteria**

We expected to find that the Commission:

- has an appropriate accountability framework;
- has mechanisms to facilitate the discharge of its mandate;
- manages its operations efficiently; and
- has systems and procedures for measuring and reporting its performance.

#### **Audit Team**

Jayne Hinchliff Milne Patricia MacDonald Jocelyne Therrien

For more information, please contact Robert W. Chen, the responsible auditor.

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Report of the Auditor General of Canada to the House of Commons

Chapter 35
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This December 1997 Report comprises 16 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, October and December 1997 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.



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## **Chapter 35**

Follow-up of Recommendations in Previous Reports

The follow-up work was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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# Follow-up of Recommendations in Previous Reports

#### **Main Points**

- 35.1 Progress toward addressing our recommendations contained in previous reports is noted in each of the follow-up segments included in this chapter. However, in most cases, additional work is needed to deal with the recommendations satisfactorily. For example, Natural Resources Canada has taken steps in the right direction, such as the development of a policy framework for radioactive waste. However, much remains to be done to find long-term solutions for Canada's nuclear fuel waste, low-level radioactive wastes and uranium mine and mill tailings.
- 35.2 The following significant areas of concern remain:
  - Five years after noting our concerns, much remains to be done to ensure that Canada is prepared for major oil and chemical spill emergencies.
  - Parliament continues to need adequate information on the risks and clean-up costs of federal contaminated sites. While some progress has been made, environmental liabilities are likely quite substantial and could materially affect the government's reported financial condition.
  - The issues reported in this chapter and in Other Audit Observations, Chapter 36, regarding on-reserve facilities funded by Indian and Northern Affairs Canada, continue to raise concerns about the Department's cost effectiveness in addressing on-reserve needs. These concerns involve deficiencies in project planning, implementation, evaluation and related matters.
- 35.3 In some cases, downsizing has resulted in many changes to programs delivered by federal government departments and agencies. We have noted several delays in addressing our recommendations as a result of program changes.
- 35.4 In two cases included in this chapter, the departments concerned performed studies or reviews in response to our recommendations, but corrective action is yet to be implemented.
- 35.5 We encourage departments and agencies to continue addressing our concerns through further corrective action.



#### Introduction

- **35.6** An integral part of our audit cycle is to review the actions taken by departments in response to observations and recommendations made in our reports and by parliamentary committees.
- **35.7** Our purpose is to report to Parliament on the progress made until corrective action has been implemented or more recent events make further action unnecessary.
- 35.8 Follow-up does not provide the same high level of assurance as an audit. Rather, it provides a moderate level of assurance that departments have acted on our recommendations, unless we note otherwise. This assurance is based on information obtained from interviews with departmental officials, document reviews, and other evidence to allow us to conclude on the plausibility of the information provided to us.
- **35.9** We normally follow up on observations and recommendations and report on their status two years after we

- publish our original chapter. Some follow-up activity is reported as a separate chapter or reported with subsequent audits of departments, or grouped to provide an overall measure of progress on numerous recommendations, such as in Chapter 18 of our October 1997 Report Revenue Canada and Department of Finance. Exhibit 35.1 provides a list of audits due for follow-up that are not included in this chapter.
- 35.10 This chapter reports on progress toward implementing our recommendations made in audits conducted between 1992 and 1995. All the follow-up reports note that progress has been made toward addressing our recommendations, and in some cases they have been fully implemented. But a large number also report that further work needs to be done before the recommendations have been dealt with satisfactorily. In some cases, the delays have been attributed to program changes, but in other cases there is no obvious reason for the delays.

Exhibit 35.1

Chapters Due for Follow-up That Are Not Included in This Chapter

Year &#</th><th>Chapter Title</th><th>Responsible Auditor</th><th>Follow-up Status</th></tr><tr><th>1992</th><th></th><th></th><th></th></tr><tr><td>24</td><td>Emergency Preparedness in the Federal Government</td><td>Alan Gilmore</td><td>Portions of the chapter are being followed up in a phased approach:  Preparedness for Major Earthquakes – Reported in Chapter 26 of the November 1995 Report  Nuclear Emergencies Planned for follow-up in 1998</td></tr><tr><td></td><td></td><td></td><td>Accidents involving Oil and Chemicals – Reported in this chapter</td></tr><tr><td></td><td></td><td></td><td>Accidents involving On and Chemicais – Reported in and Chapter</td></tr><tr><td>1993</td><td></td><td>711</td><td>Reported in Chapter 13 of the October 1997 Report</td></tr><tr><td>19</td><td>Department of National Health and Welfare – Non-insured Health Benefits</td><td>Ellen Shillabeer</td><td>Reported in Chapter 15 of the October 1997 Report</td></tr><tr><td>20</td><td>Revenue Canada – Advance Income Tax Rulings, GST Rulings and Interpretations</td><td>Barry Elkin</td><td>Reported in Chapter 18 of the October 1997 Report</td></tr><tr><td>22</td><td>Department of Transport – Airport Transfers</td><td>Hugh McRoberts</td><td>Deferred from 1995 as no further transfers had been made to airport authorities. To be included in a new chapter, tentatively planned to report in 1999.</td></tr><tr><td>1994</td><td></td><td></td><td></td></tr><tr><td>10</td><td>Science and Technology – Management of Departmental Science and Technology Activities</td><td>Richard Flageole</td><td>Deferred, as the government will be implementing its new strategy on Science and Technology. Tentatively planned to report in 1998.</td></tr><tr><td>11</td><td>Science and Technology – The Management of Scientific Personnel in Federal Research Establishments</td><td>Jacques Goyer</td><td>Portions of the chapter are being followed up in a phased approach:  The overall human resources management framework was followed up in Chapter 15 of our September 1996 Report.  The remaining portion has been deferred, as the government will be</td></tr><tr><td></td><td></td><td></td><td>implementing its new strategy on Science and Technology. Tentatively planned to report in 1998.</td></tr><tr><td>12</td><td>Aspects of Federal Real Property Management</td><td>Reno Cyr</td><td>Deferred. Government downsizing has resulted in departments being restructured and will result in a shift in focus for the follow-up. Tentatively planned to be combined with an audit of this area planned to report in 1999. See Chapter 34 below.</td></tr><tr><td>18</td><td>Correctional Service Canada – Supervision of Released Offenders</td><td>David Brittain</td><td>Deferred. Tentatively planned to be combined with an audit of this area planned to report in 1998.</td></tr><tr><td>22</td><td>Foreign Affairs and International Trade Canada</td><td>John Hitchinson</td><td>Reported in Chapter 9 of the April 1997 Report.</td></tr><tr><td></td><td colspan=5>Revenue Canada:</td></tr><tr><td>28</td><td>- Customs Assessment Activities</td><td>Jim Ralston</td><td>Reported in Chapter 18 of the October 1997 Report.</td></tr><tr><td>29</td><td>- Collecting Income Tax Debts</td><td>Basia Ruta</td><td></td></tr><tr><td>30</td><td>- GST: Audit and Special Investigations</td><td>Jim Ralston</td><td></td></tr><tr><td>31</td><td><ul>     <li>Ensuring Fairness of the Income Tax System: Detection of Non-Filers and Special Investigations</li> </ul></td><td>Jim Ralston / Barry Elkin</td><td></td></tr><tr><td>32</td><td>Department of Finance and Revenue Canada – Income Tax Incentives for Research and Development</td><td>Barry Elkin</td><td></td></tr></tbody></table>
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#### Exhibit 35.1 (cont'd)

Year &#</th><th>Chapter Title</th><th>Responsible Auditor</th><th>Follow-up Status</th></tr><tr><td>33</td><td>Department of Finance and Revenue Canada – Tax Assistance for Retirement Savings</td><td>Barry Elkin / Michael Adibe</td><td>Reported in Chapter 18 of the October 1997 Report.</td></tr><tr><td>34</td><td>Public Works and Government Services Canada – Management and Operation of Crown-owned Office Buildings</td><td>Michael Weir</td><td>Deferred. Government downsizing has resulted in departments being restructured and will result in a shift in focus for the follow-up. See Chapter 12 above. Tentatively planned to be combined with an audit of this area planned to report in 1999.</td></tr><tr><td>1995</td><td></td><td></td><td></td></tr><tr><td>1</td><td>Ethics and Fraud Awareness in Government</td><td>Alan Gilmore</td><td>Reported in Chapter 1 of this Report. Other audits of this area are planned in the next three years.</td></tr><tr><td>4</td><td>Health Canada – Management of the Change Initiative at Health Protection Branch</td><td>Dan Rubenstein</td><td>Deferred. Tentatively planned to be combined with an audit of this area planned to report in 1998.</td></tr><tr><td>5</td><td>Office of the Superintendent of Financial Institutions – Deposit-Taking Institutions Sector</td><td>Beant Barewal</td><td>Deferred. Tentatively planned to be combined with a follow-up of Chapter 30 of this Report. Planned to report in 1999.</td></tr><tr><td>6</td><td>Federal Transportation Subsidies  - The Western Grain Transportation Act Program</td><td>Hugh McRoberts</td><td>Cancelled. These programs have been terminated by the government.</td></tr><tr><td></td><td>- The Atlantic Region Feight Assistance Program</td><td></td><td></td></tr><tr><td>8</td><td>Travel under Foreign Service Directives</td><td>Trevor Shaw</td><td>Reported in Chapter 9 of the April 1997 Report.</td></tr><tr><td>9</td><td>Information for Parliament – Deficits and Debt: Understanding the Choices</td><td>Jeff Greenberg</td><td>Deferred. Tentatively planned to be combined with an audit of this area planned to report in 1998.</td></tr><tr><td>10</td><td>Crown Corporations – Fulfilling Responsibilities for Governance</td><td>Grant Wilson</td><td>Portions of the chapter are being followed up in a phased approach:  • Performance measurement is followed up in Chapter 22 of this Report.  • Further follow-up on special examinations is planned to report in 2000.</td></tr><tr><td>11</td><td>Environmental Management Systems: A Principle-based Approach</td><td>Wayne Cluskey</td><td>This chapter contained findings from a study conducted by the Office and contained no recommendations or observations that are subject to follow-up.</td></tr><tr><td>12</td><td>Systems under Development: Managing the Risks</td><td>Eric Anttila</td><td>Reported in Chapter 23 of this Report.</td></tr><tr><td>13</td><td>Canadian International Development Agency – Phased Follow-up of the Auditor General's 1993 Report – Phase I</td><td>Vinod Sahgal</td><td>This chapter was the first segment of a phased follow-up to Chapter 12 of our 1993 Report. Phase II was reported in Chapter 29 of our 1996 Report. Phase III is tentativeley planned to report in 1998.</td></tr><tr><td>15</td><td>Public Works and Government Services Canada – Northumberland Strait Crossing Project</td><td>Tony Brigandi</td><td>Deferred. Tentatively planned to report in 1998.</td></tr><tr><td>16</td><td>Revenue Canada – Air Transportation Tax</td><td>Jim Ralston</td><td>Reported in Chapter 18 of the October 1997 Report.</td></tr><tr><td>17</td><td>Overview of Regional Economic Development Programs</td><td>Roger Simpson</td><td>This chapter contained an overview and common issues from Chapters 18, 19, 20 and 21. Follow-up of recommendations from each of these chapters is included in this Report.</td></tr><tr><td>24</td><td>Revolving Funds in the Parliamentary System – Financial Management, Accountability and Audit</td><td>Michael Weir</td><td>Deferred. Tentatively planned to report in 1998.</td></tr><tr><td>25</td><td>Revenue Canada – The New Regime for Processing Income Tax Returns</td><td>Basia Ruta</td><td>Reported in Chapter 18 of the October 1997 Report.</td></tr></tbody></table>
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# Emergency Preparedness in the Federal Government — Accidents Involving Oil and Chemicals — 1992, Chapter 24

Assistant Auditor General: David Rattray Responsible Auditor: Alan Gilmore

#### **Background**

In 1992 we reported on 35.11 emergency preparedness in the federal government. As part of that audit, we examined the government's ability to respond to three types of major disasters - earthquakes, nuclear emergencies and oil and chemical spills. In our November 1995 Report, we followed up on earthquake preparedness and, in particular, on the results of the 1994 CANATEX II exercise that dealt with response to a catastrophic earthquake in British Columbia. Among other things, we found that although valuable lessons were learned from it, the exercise did not provide a fully adequate basis for evaluating the effectiveness of the National Earthquake Support Plan.

35.12 This year we followed up on the section of the 1992 Report that dealt with accidents involving oil and chemicals. We examined the progress made in three important areas — marine oil spills, marine chemical emergencies, and non-marine chemical emergencies at industrial sites. We did not review preparedness for chemical emergencies that occur during transportation by land.

#### Conclusions

35.13 Since our 1992 audit, the government has established a private-sector-based marine oil spill response regime, which is expected to be certified and monitored by the Canadian Coast Guard and funded by ship and oil-handling facility operators. The

Canadian Coast Guard has put extensive effort into establishing this regime; however, there is a major dispute over the fairness and equity of the proposed fees to fund the regime. These fees have not yet been approved by the Minister of Fisheries and Oceans. If the government is unable to resolve the dispute, the regime will not be financially viable. A consultant study on the subject is expected to report in the fall of 1997 on possible options.

35.14 Progress has been slow in establishing a system to respond to marine chemical emergencies. There are no national or regional plans to deal with marine chemical accidents. However, the Coast Guard is now in the preliminary stage of developing a chemical emergency response regime in conjunction with industry.

35.15 In our 1992 Report, we indicated that Canada did not have a national legislative framework for land-based chemical accidents. Such a framework is still not in place. However, since our 1992 audit, Environment Canada has drafted proposed amendments to the *Canadian Environmental Protection Act* (Bill C-74) that include a section dealing with environmental matters related to emergencies. Bill C-74 did not reach second reading in Parliament.

**35.16** The Major Industrial Accidents Council of Canada (MIACC) has made progress but now needs to focus on increasing awareness and encouraging action, particularly on the risk assessment of hazardous installations.

35.17 To date, MIACC has identified a list of hazardous substances and developed an initial inventory of hazardous sites. It has identified about 1,350 hazardous sites containing substances that could, if improperly handled, lead to a major accident. These sites contain substances such as vinyl chloride, benzene, and gasoline. The inventory of hazardous sites has not yet been completed. MIACC is sending a survey to hazardous site operators for self-assessment of their safety management practices. The results of the survey are expected in the spring of 1998.

#### Observations

#### Marine oil spills

- 35.18 Major problems have been encountered in implementing the marine oil spill preparedness and response regime. Approximately 60 million tonnes of oil and petroleum products are loaded and unloaded annually in Canadian ports and within Canadian waters. In 1993, the last year for which spill data are available, there were 654 reported ship and shore-based marine oil pollution incidents, including intentional discharges. Following the occurrence of two high-profile oil spills in the late 1980s, the Nestucca and the Exxon Valdez, the government convened the Public Review Panel on Tanker Safety and Marine Spills Response Capability.
- **35.19** The September 1990 report of the Public Review Panel was highly critical of preparedness for oil spills. The shortfall in spill response capability was seen by the Coast Guard to be the most pressing priority among the report's many findings. The report stated:
  - The capability to respond effectively to a marine spill of any significant

- magnitude does not presently exist anywhere in Canada.
- Each year, Canada can expect over 100 small spills (less than a tonne), about 10 moderate spills (about 100 tonnes), and at least one major spill (100 to 10,000 tonnes) from oil tankers. A catastrophic spill (greater than 10,000 tonnes), for which we are totally unprepared, can be expected once every 15 years.
- 35.20 The report recommended that within each region of Canada the "integrated industry-government spill response capacity must be sufficient to address marine spills up to 10,000 tonnes." The report recommended an investment of between \$150 million and \$200 million over five years in order to increase regional clean-up capacity to the minimum acceptable level.
- 35.21 In October 1991, the Treasury Board approved an increase of \$100 million over a six-year period for the Coast Guard, Environment Canada and Fisheries and Oceans to implement a strategy that responded to the key recommendations of the Panel. In 1993 an additional \$15.9 million was provided to the Coast Guard and \$1.2 million was provided to Environment Canada. In our 1992 Report, we noted that initiatives were only in the beginning stages or had not yet started.
- 35.22 Since 1992, the Coast Guard has done a significant amount of work to establish a marine oil spill preparedness and response regime. Amendments to the *Canada Shipping Act* enabling the implementation of the new regime were proclaimed on 15 August 1995. Among other things, amendments to the Act require that vessels and oil-handling facilities have emergency response plans. Vessels and designated oil-handling facilities are also required to have an arrangement with a response organization

The September 1990 report of the Public Review Panel on Tanker Safety and Marine Spills Response Capability was highly critical of preparedness for oil spills.

that has been certified by the Coast Guard to respond to a spill equal to the total amount of oil on board, up to a maximum of 10,000 tonnes.

- **35.23** The Coast Guard assessed two alternatives for funding the required upgrade of Canada's oil spill response capability:
- industry funding through a direct levy on oil imports and exports by ship; or
- a partnership approach involving joint government-industry arrangements for a response capability funded and operated by the private sector.
- In 1993, after consultations with the oil and shipping industries, the second approach was chosen. It was decided that the Canadian Coast Guard would set standards, certify the response organizations and monitor spill response. Five "response organizations" were created by the oil industry to provide a spill response capability south of 60° north latitude. The response organizations are required to submit response plans that demonstrate an ability to respond to an oil spill within a given geographic area of response. The Coast Guard assumes operational control of an oil spill response operation only if the polluter is "unidentified, unable or unwilling" to manage the operation, if the spill is north of 60° north latitude, or if the spill is a "mystery spill".
- 35.25 A Panel was established to investigate the fairness of fees for assuring oil spill response capability. The cost of establishing the response organizations was to be paid by fees collected from companies that could be involved in oil spills. The Coast Guard did not determine the fee to be charged; this was left to each response organization. The payment of the fee is for assurance of response capability in the event of a spill,

not for actual response. If a ship or an oil-handling facility chooses to use the services of a response organization in the event of a spill, those services would be charged separately.

- by the Minister, they must be published in the *Canada Gazette*. On 16 September 1995, the fees proposed by the five Coast Guard-certified response organizations were published in the *Canada Gazette*. The proposed fee structure for four of the five response organizations consists of an initiation fee, a registration fee and a bulk oil cargo fee. One of the five response organizations excludes the initiation fee but charges a bunker fee. The proposed fees are:
- Initiation fee. This is a one-time payment of \$200 by both ships and designated oil-handling facilities. In the case of one of the response organizations, a bunker fee applies instead of the initiation fee. The bunker fee is to be paid by ships at a rate of \$100 for each transit through the response organization's area of response.
- Registration fee. This is an annual fee of \$450 charged to both ships and designated oil-handling facilities.
- Bulk oil cargo fee. This is a levy based on the basis of the volume of oil handled multiplied by the bulk oil rate. The fee applies to designated oil-handling facilities for all oil that is unloaded or oil destined for foreign locations that is loaded at the facility. Where non-designated oil-handling facilities that do not have an arrangement with a response organization are involved, the fee is payable by the ship. The fee is a single rate expressed on a per tonne basis. It ranges across response organizations from 22.5 cents to \$1.85 per tonne.
- **35.27** Under Chapter 36 of the *Canada Shipping Act*, anyone who has reason to believe that the proposed fees are not fair

and equitable can file a notice of objection with the Minister within 30 days of publication. Objections related to the fairness and equity of the proposed fees were received from 31 corporations, organizations and individuals within the 30 days. The objectors included vessel operators, independent oil-handling facility operators, and consignees, for example, airlines and power-generating facilities.

35.28 On 4 March 1996, the Minister of Fisheries and Oceans announced an investigation into the fairness and equity of the proposed fees and appointed a three-member Oil Spill Response Organization Fee Structure Investigation Panel. The Panel submitted its final report on 27 August 1996 to the Minister of Fisheries and Oceans.

The Panel criticized the overall 35.29 approach to oil spills adopted by the Coast Guard. The Panel noted that the Coast Guard "continued to have prime responsibility for spill response, but had basically become a licensing authority for private sector response capability, but without any residual controls." The Panel stated that the approach adopted "appeared to have been driven by the prevailing policies developed by the previous federal government intent on conveniently abrogating certain government responsibilities and simply maintaining a minimum of control." It called for the Coast Guard to re-establish its principal role in the area of oil spill response and recommended that this be done by establishing a "National Spill Response Agency" that would be a "truly integrated public-private partnership between the Canadian Coast Guard, the oil and shipping industry and response organizations."

35.30 Preparedness for oil spills has been enhanced but a complete

assessment is needed. The Panel's report concluded that the response organizations are professionally managed and staffed and their equipment and resources are considered fully adequate to meet the standards set down by the Coast Guard. We note that since our 1992 audit:

- ships and designated oil-handling facilities are now required to have oil pollution emergency plans as well as an arrangement in place with a response organization certified to provide a response capability; and
- a national marine spill response exercise program has been developed.
- 35.31 Additional oil spill response equipment also has been acquired; however, the Coast Guard reports that the dollar value of response organization and Coast Guard stockpiles is below the investment recommended by the Public Review Panel on Tanker Safety and Marine Spills Response Capability.

The Canada Shipping Act now requires that the Minister review the "capability of response organizations to meet the arrangements required by ships and oil-handling facilities" and report to Parliament. The first Report to Parliament (1996) was mainly a description of the development of the new regime. The report indicates that the 1998 Report to Parliament will contain a more detailed account of the effectiveness of the regime. However, to make an assessment of the adequacy of the current Canadian oil spill response regime, the Coast Guard would have to carry out a review to verify the oil spill response capacity of the response organizations. Without such a review, the Coast Guard cannot conclude that the response capability for oil spills is satisfactory.

35.33 Exercises are one means of assessing the effectiveness of the response organizations. Under the *Canada Shipping* 

The Panel concluded that the oil spill response fee structure is unworkable since it is neither fair nor equitable.

An inability to resolve the fee structure issues means that the oil spill regime will not be financially viable. Act regulations, response organizations are required to evaluate the effectiveness of all aspects of the procedures, equipment and resources that are identified in the response plan through an exercise program. The program must be carried out at least once during a three-year period that begins on the day on which the certificate of designation is issued. The Coast Guard is responsible for monitoring the exercise program. Officials are concerned that they may not have the resources to fully monitor and assess response organization exercises.

- 35.34 The Panel concluded that the oil spill response fee structure is unworkable. The Fee Structure Investigation Panel criticized the Coast Guard for withdrawing from active control of the new regime by not setting the fee structure and concluded that the proposed oil spill response fee structure is unworkable since it is neither fair nor equitable. With respect to the major objections, the Panel concluded:
- The objectors' assertion that response organizations are unregulated monopolies is valid. This is compounded by the collusive relationship in the system, that is, oil companies are the major shippers of oil and owners of many of the oil-handling facilities and, at the same time, are the owners of the response organizations.
- Multiple fees are unfair and inequitable because a ship traversing several regions with the same risk could potentially be charged different fees.
- The "one fee fits all" fee structure is clearly inconsistent with the concept of a risk-based fee.
- Objections regarding unfair costing procedures are conjectural based on limited information obtained by objectors; however, concern about the high rate of return on investment and certain

- inconsistent practices in establishing the cost base is legitimate. The report concluded that the proposed fees are set to generate a level of revenue that will cover all costs plus a return on investment, and that the majority of the response organizations have built into the fee structure a rate of return on capital invested of almost 20 percent on a before-tax basis.
- The objection on the ground that the proposed fees would place a greater burden on some companies than on others is plausible.
- 35.35 Problems surrounding the new oil spill response regime fee structure remain unresolved. The Coast Guard engaged a consulting firm in the fall of 1996 to carry out a detailed analysis of response organizations' financial data in order to determine the fairness of the proposed fees as published in the Canada Gazette. This review is taking longer to complete than first anticipated; it is expected to be completed in the fall of 1997.
- **35.36** The Coast Guard is also awaiting the results of another consultant's report that is intended to develop options on:
- institutional arrangements for the Coast Guard within the existing policy framework:
  - fee structure; and
- ensuring effectiveness of the response regime.
- 35.37 An options paper will be prepared for the Minister of Fisheries and Oceans and the Coast Guard. The Coast Guard anticipates that stakeholder consultation on these options will be completed by mid-autumn of 1997.
- **35.38** We recognize that extensive effort has gone into amending the *Canada Shipping Act* and establishing a marine oil spill response regime. However, given the

Panel's conclusions that the current fee structure is unworkable, we are concerned about the viability of this regime. Since Canada's response capability is now to be based on private arrangements between ships and oil-handling facilities and response organizations for which a fee is paid, an inability to resolve the issues related to the proposed fee structures and broader policy issues means that the regime will not be financially viable.

#### Marine chemical emergencies

The Coast Guard believes the 35.39 probability of a major marine chemical incident is relatively low but consequences may be significant. In 1994 the total domestic and international trade in hazardous materials - both in bulk and in containers — was approximately 15 million tonnes. A study commissioned by the Coast Guard stated that the development of a chemical emergency response regime must consider that although the probability of a major accident is low, the environmental consequences of a chemical spill may be significant. A chemical incident may be less likely to occur than an oil spill; however, because of the differences between oil and chemicals, the consequences may be far more severe. The Coast Guard lists some of the key differences that indicate why the consequences of a chemical incident can be more significant, depending on the substance(s) involved:

- There are a limited number of oil commodities, whereas more than 300 chemical products are shipped in bulk and thousands are shipped in containers.
- Oil products have similar physical properties, while there is a wide range of physical properties, such as flammability, toxicity and corrosiveness, among chemicals.

- In the case of oil, toxicity to humans is low. With chemical products there is a wide range of toxicity, with some being carcinogenic or immediately fatal.
- Oil has an immediate and visible impact on birds and marine life. Chemicals may have delayed and chronic effects.
- The impact of an oil spill is generally proportional to the size of the spill. The impact of a chemical spill is a function of the intrinsic properties of the chemical and is compounded by spill size.
- Oil does not react violently if mixed with water and/or other products.
   Chemical cargoes may react violently if mixed or upon contact with water or other materials.
- 35.40 The Coast Guard does not maintain a database on the frequency or nature of marine chemical incidents, but it believes that the incidence is relatively low. Some preliminary statistics, collected from various sources, were assembled as part of an internal study. The study identified a total of 87 reported incidents involving hazardous chemicals in a marine environment for the years 1991 to 1995 an average of 17 identified incidents annually. None of these were major incidents.
- **35.41** The absence of good statistics on oil and chemical incidents is an area of concern and the Coast Guard indicates that it is in the process of pilot testing a Pollution Incident Reporting System to provide more comprehensive information on the nature and frequency of spills.
- 35.42 There has been limited progress in developing a marine chemical response capability. The report of the Public Review Panel on Tanker Safety and Marine Spills Response Capability concluded that Canada's ability to respond to marine spills of hazardous materials is, at best, limited. Although the Coast Guard

The consequences of a chemical spill may be far more severe than those of an oil spill. has done some work in this area — for example, a review of practices of other countries, adoption of fundamental principles for design of the system and consultation with industry — progress in resolving this problem has been slow. At present, there is no national or regional integrated plan to deal with major marine chemical accidents.

35.43 The limited progress in this area is due, in part, to the difficulties in trying to first establish the marine oil spill preparedness and response regime. The oil spill regime was seen to be a priority because of the Public Review Panel's report and the two highly visible oil spills involving the Nestucca in 1988 and the Exxon Valdez in 1989.

35.44 The Coast Guard has indicated that it is now in the preliminary stage of developing a chemical emergency response regime in conjunction with industry. A fundamental requirement in developing this regime will be to clearly identify the roles, responsibilities and capabilities of government and industry.

#### Non-marine chemical emergencies

Much remains to be done on the recommendations of the Bhopal Aftermath Review. Following the 1984 Bhopal chemical accident, Environment Canada led a joint industry-government task force that examined the potential for Bhopal-type accidents in Canada. The resulting 1986 report, Bhopal Aftermath Review: An Assessment of the Canadian Situation, stated that the possibility of a major industrial accident does exist in Canada. The report suggested that the probability and impact of such an event could be significantly reduced if risks were properly identified and evaluated and contingency plans developed. The recommendations of the report related to both industry and all levels of government.

35.46 In 1996 Environment Canada assessed the progress by all levels of government and industry on the report's 21 recommendations, which were broken down into a total of 49 sub-recommendations for the analysis. The assessment rated the implementation of about half of the 49 sub-recommendations as "fair", meaning that most of the target audience is aware of what is needed but little or no action has taken place. "Good" ratings were given to 29 percent of the sub-recommendations, indicating that action steps have been implemented but that coverage is uneven, with critical gaps. A further 16 percent of the sub-recommendations were rated as "excellent", indicating full implementation. The report concludes that "good to excellent progress has been made on the development of products but the dissemination of these products to the industrial and municipal communities has only just begun."

35.47 A legislative framework for chemical accidents at industrial sites is not in place. In our 1992 Report, we indicated that Canada, unlike most modern industrialized countries, did not have a national legislative framework for chemical accidents at industrial sites that would provide for requirements on the reporting of chemicals used by industry, preparation of emergency plans, safety audits and reporting of spills. A legislative framework is still not in place and we believe that this is needed to provide a sound regulatory basis to complement voluntary initiatives.

35.48 A 1994 Environment Canada issues paper, prepared for the review of the *Canadian Environmental Protection Act*, noted that the existing approach to environmental emergencies has tended to

be reactive and has not focussed on public concerns about prevention and the right to know. With a shift in focus to the prevention of emergencies, it is important to first know the location of sites holding quantities of hazardous substances that pose a potential threat of off-site damage to the environment and the public. Once the sites are known, it would then be possible to assess the risks posed and raise awareness about these risks. Legislation would help implement these preventive measures; for example, it could provide the authority to have sites registered and to ensure that site operators assess the extent to which preventive and preparedness measures are in place.

35.49 Since our 1992 audit,
Environment Canada drafted proposed amendments to the *Canadian*Environmental Protection Act, which the government introduced as Bill C-74 in
December 1996. The Bill included a part of the Act dealing with environmental matters related to emergencies. This part of the Act would have given the Governor in Council, on the recommendation of the Minister, enabling authority to make regulations related to:

- establishment of a list of hazardous substances and minimum quantity related to each substance;
- identification of places where substances are located (in the prescribed quantities);
- the prevention of, preparedness for, response to and recovery from environmental emergencies;
- notification and reporting of environmental emergencies; and
- notification and reporting of preventive measures or measures to repair, reduce or mitigate any negative effects of environmental emergencies.

**35.50** Bill C-74 did not reach second reading in Parliament. It is not known at this time whether the Bill will be reintroduced.

MIACC has made progress but now needs to focus on risk assessment. In our 1992 Report, we noted that one of the important recommendations of the Bhopal Aftermath Review that had been implemented was the establishment of the Major Industrial Accidents Council of Canada (MIACC). Environment Canada sees the partnership approach, promoted through MIACC, as the best means of preventing accidents and building preparedness in an area of fragmented jurisdiction. MIACC, which is viewed as an alternative to a strictly governmental regulatory approach, receives an annual contribution from the federal government, which will be about \$200,000 in 1997-98. It also receives funding from provinces, municipalities and industry. The mission of MIACC is to reduce the frequency and severity of major industrial accidents involving hazardous substances and to achieve harmonization in prevention, preparedness and response programs.

MIACC has made progress but 35.52 now needs to focus on encouraging action, particularly on the risk assessment of hazardous installations. Until recently, MIACC has concentrated on developing new tools, such as training courses, guides and standards, for those working in the areas of prevention, preparedness and response. MIACC now sees itself shifting to a focus on "sensitization" - making target groups such as site operators and relevant community officials aware of risks and gaining their commitment to act to minimize risk. This change in focus is reflected by the work MIACC is currently doing with respect to hazardous installations and community preparedness.

With a shift in focus to prevention, it is important to first know the location of sites holding significant quantities of hazardous substances.

The Major Industrial
Accidents Council of
Canada (MIACC)
informed us that
approximately 1,350
hazardous sites have
been identified to date.

This work relates to observations made in our 1992 Report.

- 35.53 In 1986, the Bhopal Aftermath Review recommended that a site-specific risk assessment for each industrial plant be carried out to determine the potential for a major industrial accident. The 1990 Green Plan also highlighted the need for an inventory of hazardous installations. In our 1992 Report, we indicated that Environment Canada did not have such an inventory and had not conducted reviews of accident prevention activities at potentially hazardous installations.
- 35.54 In 1995, the Report of the Standing Committee on Environment and Sustainable Development recommended that all sites be identified and registered, including sites owned by the federal government, where hazardous substances are found in quantities exceeding specified threshold amounts. The Committee suggested that the list of hazardous substances could be drawn up based on those already identified by MIACC and that the list could then be made available to local fire stations, those in charge of emergency preparedness and the general public if necessary.
- 35.55 MIACC is developing an inventory of hazardous sites and encouraging site operators to undertake risk assessments. Environment Canada informed us that it does not have the mandate to undertake assessments of hazardous sites, but it is working with MIACC in taking steps to address the issues of hazardous site identification and assessment.
- 35.56 The first step in assessing risks posed by hazardous sites is to identify the priority substances. MIACC has developed lists of hazardous substances and the threshold quantities above which the substances could present hazards to

- on-site workers, the general public, property and the environment if not handled properly. The presence of the substances on these lists at the threshold quantities does not necessarily mean there is an unacceptable level of risk. The risk becomes unacceptable when measures are not in place to manage the substances properly. The substances on "MIACC List 1" are those that could lead to major accidents if improperly handled, for example, vinyl chloride, benzene, and gasoline.
- 35.57 The second step is to establish an inventory of hazardous sites. MIACC is currently preparing an inventory of sites that have "MIACC List 1" substances in such quantity that they pose a risk of injury or death to people outside the site in the community. MIACC informed us that approximately 1,350 sites have been identified to date.
- 35.58 The third step is to assess the risk at each hazardous site. MIACC has begun the process of conducting a survey of process safety management. This is a self-assessment designed to determine the current level of awareness and use of major accident prevention and preparedness techniques at sites in Canada with potential for major hazards. Results of the survey are expected in the spring of 1998.
- 35.59 MIACC informed us that there are "MIACC List 1" hazardous sites located in approximately 450 communities. It is conducting a survey of the state of community emergency preparedness in these communities. This is being done, in most cases, through provincial agencies with emergency preparedness responsibilities.
- **35.60** MIACC's study of hazardous sites does not cover federal sites. Environment Canada indicated that it does not have responsibility for establishing an

inventory of federal sites and that departments are responsible for their own sustainable development strategies and environmental management systems. However, Environment Canada has recently completed a study that identifies some federal sites where "MIACC List 1" substances are used or stored. The purpose of this study was to assess the actions that some federal departments have instituted in the areas of accident prevention, preparedness and emergency response. It

should be noted that of the 20 sites studied, only one had stored a substance in a quantity exceeding the MIACC threshold limit. The study proposed a number of action items, including the development, in the federal government, of accurate inventories of federal facilities, the development of training programs regarding hazardous substances, increasing the awareness of MIACC tools and the development of a generic risk assessment document.

### Correctional Service Canada — Custody of Inmates — 1994, Chapter 16

Assistant Auditor General: Maria Barrados Responsible Auditor: Robert W. Chen

#### **Background**

Service Canada, we reported on activities relating to the custody of inmates. We made a number of observations and recommendations concerning the design and application of the security classification system and the management of accommodation functions. Upon reviewing our audit, the Public Accounts Committee, in its Thirteenth Report released in June 1995, endorsed these recommendations. It also recommended that Correctional Service find savings in headquarters costs.

35.62 Our follow-up consisted of reviewing status reports prepared by Correctional Service on the progress it has made on our recommendations. We also reviewed the supporting documentation prepared by the Service and had discussions with its officials.

Conclusion

35.63 The Service has carried out a number of activities in response to the recommendations of our Office and the Public Accounts Committee in the area of security classification. However, continued management attention is needed if the Service is to further improve the objectivity of its security classification system. Such a system is critical for minimizing the risk to public safety and reducing prison operating costs. The Service needs to establish a process to monitor regularly the use of overrides of its Custody Rating Scale and to provide additional training to its staff on the use of the Scale when such needs are identified

through monitoring. Sustained efforts are also needed to ensure that a more objective reclassification instrument will be fully implemented by 1999.

Correctional Service has acted on 35.64 all our recommendations pertaining to accommodation planning, including using cost/benefit analysis in evaluating future accommodation projects, incorporating double-bunking and shared-accommodation strategies in its accommodation planning, and appointing a full-time senior executive responsible for all accommodation-related functions. We noted that the Service has clarified its definition of double-bunking to exclude custom-designed, shared accommodation and is planning to review its overall accommodation policy. These changes, in our opinion, need to be carefully addressed in its accommodation planning process.

#### **Observations**

**Security classification** 

Audit observations in 1994. The 35.65 practices of other jurisdictions and studies anchored by empirical data led us to conclude that an objective system is needed for both classifying inmates according to the risk they present and assigning them to the appropriate institution. Such a system uses statistically derived classification instruments to ensure that all known risks factors are considered and given proportional weight when determining a classification. In any well-designed security classification system, the results flowing from the instruments used can be overridden by

In the area of security classification, continued management attention is needed.

staff where, in their opinion, an instrument fails to take into account such things as a medical condition, a psychologist's report, rehabilitation program vacancies, or proximity to the inmate's home. To remain relevant and to ensure their continuing validity, classification instruments need to be revised periodically to reflect actual experience.

35.66 Overall, an objective system uses instruments that allow for consistency in decision making and for decisions to be more easily monitored. These benefits are difficult, if not impossible, to realize if the classification instrument relies only on subjective, qualitative information (commonly referred to as "gut feel") that allows individual staff members to introduce biases that may or may not be valid.

35.67 At the time of our 1994 audit. Correctional Service had a two-step classification process, not unlike many other jurisdictions. Inmates entering the federal correctional system upon sentencing were given an initial custody rating followed by a reassessment on an annual basis. As we noted in 1994, we were concerned that although Correctional Service has an initial classification instrument (the Custody Rating Scale) that is quantitative and objective, reclassifications (the Security Classification Review) are qualitative in nature and based almost totally on the individual judgment of case management officers. As a result, inmates with similar risk factors have been reclassified and placed in institutions with different and, possibly, inappropriate security levels.

**35.68** From these observations, we, and later the Public Accounts Committee, recommended that Correctional Service improve its security classification system to make it more objective and allow for monitoring of results.

#### 35.69 Follow-up audit observations.

Our follow-up review confirmed that immediately following our audit, the Service required all case management staff to attend a three-day risk assessment course. This course emphasized the use of statistically derived instruments over that of subjective methods, as well the importance of always taking into consideration the risk to public safety when making case management decisions. The Service estimates that between 2,000 and 3,000 of its staff have completed the course. As well, the Service has continued to affirm these messages at training workshops and staff conferences and during routine queries and site visits.

35.70 By the end of 1994, Correctional Service began to apply the Custody Rating Scale to all offenders entering the system. However, the Service also required its staff to immediately apply its Security Classification Review guidelines, which had been used to change or override inmates' security classifications as determined by the Scale. In our opinion, this practice at offender intake assessment has been a significant factor in the large number of Scale overrides. In August, 1997, the Service issued a directive to stop this practice.

35.71 In 1996, Correctional Service completed a validation study of the Custody Rating Scale that confirmed that the Scale is well designed. This same study noted a 26 percent override rate and estimated that only about half of the overrides were for legitimate reasons. This level of overrides, in our opinion, indicates a continuing need for the Service to better train its staff on what constitutes a valid override.

**35.72** The Service has not yet implemented a process to monitor regularly the extent of overrides. It is therefore unable to respond to the Public

Sustained efforts are needed to ensure that a more objective reclassification instrument will be fully implemented by 1999.

Correctional Service has acted on all our recommendations pertaining to accommodation planning.

Accounts Committee's request that the Service assess, on an annual basis, the needs and level of understanding of its staff with regard to the Custody Rating Scale, and provide additional training as needed. The Service told us that beginning in December 1997, it will be able to report the number of and reasons for overrides.

35.73 Since the beginning of 1996, a considerable amount of work has gone into developing a new, more quantitative reclassification instrument used for security classification review. Correctional Service's Executive Committee is expected to approve the new instrument for field testing in November 1997. Following approval, additional field consultations, testing and validation will be required in addition to automating the instrument on its Offender Management System. The Service estimates that this instrument will be in place for use, at the earliest, by the end of 1998.

35.74 From the Offender Management System, Correctional Service now has better information to evaluate periodically the extent of overplacements or underplacements, that is, the number of inmates who are placed in institutions of a security level greater or lesser than the classification assigned to them. This information has been presented to and reviewed by the Service's Executive Committee and, subsequently, has been used by the Service to make periodic reviews of minimum security institutions to ensure that the risk from these institutions is minimized.

35.75 We noted that Correctional Service intends to use these security classification data for population forecasting and accommodation planning as recommended in our audit. This will begin January 1999 because four to five years of data are normally required to begin accurate forecasting.

#### Inmate accommodation

35.76 Audit observations in 1994. In 1994 we observed significant weaknesses in inmate accommodation planning. We noted that required life-cycle cost/benefit analyses were not performed and that Correctional Service had been slow to consider shared accommodation (cells designed and built to accommodate more than one person) as an option in accommodation planning.

Follow-up audit observations. 35.77 Our follow-up review confirmed that all our recommendations in this area have been implemented. Correctional Service and the Treasury Board had agreed on a specific cost/benefit model in 1995, training for its use was provided to staff in both national and regional headquarters. and the model was used in the Service's 1996-97 and 1997-98 capital and accommodation planning. The position of Assistant Commissioner, Corporate Development was created and given responsibility for co-ordinating strategic and operational planning, of which accommodation planning is one aspect.

35.78 Correctional Service guidelines further indicate that double-bunking and shared-accommodation strategies have been incorporated as part of the planning process. Shared accommodation in housing other than cells has been developed and built by the Service. We noted that Correctional Service has clarified its definition of double bunking and is planning to review its inmate accommodation policy because, in its view, double occupancy is "an inappropriate permanent accommodation measure for good corrections."

#### **Headquarters costs**

**35.79 Follow-up on PAC recommendation.** The Public Accounts Committee recommended that

Correctional Service find savings in headquarters costs. Based on our analysis of 1993–94 and 1994–95 cost figures provided by the Service, the average headquarters cost per inmate had decreased from the calculation included in our Report, which was based on 1992–93

data. This reduction was due largely to the downsizing efforts of Correctional Service at both its national headquarters and five regional headquarters, as well as to economies of scale obtained from a significant increase in the number of inmates.

#### National Parole Board — 1994, Chapter 17

Assistant Auditor General: Maria Barrados Responsible Auditor: Robert W. Chen

#### **Background**

In our 1994 audit of the National 35.80 Parole Board, we made a number of observations and recommendations regarding the appointment and development of Board members, the process used to make parole decisions and the completeness of information for decision making. Our follow-up in 1997 included a review of the status report prepared by the Board for the Public Accounts Committee on the progress made on our earlier recommendations. We also reviewed the supporting documentation provided to us by the Board and had discussions with its officials.

Conclusion

The Board has taken action and implemented all the recommendations in the areas within its control. It has made changes to the process for selecting Board members. Their selection is now open to all suitable candidates and is based upon the applicant's skills and abilities. As well, the Board has implemented a rigorous training program that is linked to a variety of performance feedback mechanisms that were not in place at the time of the 1994 audit. Our recommendations on ensuring that relevant offender information provided by Correctional Service Canada is available for decision making and on how it is provided will be followed up in our 1998 review of our 1996 Report chapter, Correctional Service Canada -Reintegration of Offenders.

#### **Observations**

35.82 The Board has instituted a process for selecting members for referral to the Solicitor General that ensures that qualified people are appointed. In 1994 we observed that there was public concern that the process for appointing Board members had resulted in the appointment of some who did not have the abilities and skills to do the job. We concluded that recent changes to the process to make it more open and merit-based should be continued and applied to part-time and full-time members.

35.83 For the purposes of our follow-up audit, we selected at random two appointments made in 1996 (one full-time member and one part-time member) to determine how the new process works. We observed that there is a standard process for choosing candidates with a background in criminal justice and an ability to apply risk assessment theory and knowledge to parole decisions. Our review confirmed that the process is applied to both full-time and part-time members and consists of the following elements:

- Board member vacancies are advertised in the *Canada Gazette*;
- applications are reviewed against detailed, specific criteria pertinent to carrying out the duties of a Board member;
- candidates are interviewed by a selection committee of senior Board officials who use a candidate-completed case study and interview guide to assess qualifications and suitability;
- a list of qualified candidates is submitted to the Solicitor General for

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consideration and recommendation to the Governor in Council; and

- appointments are made by Governor in Council from this list.
- 35.84 A comprehensive training regime for Board members has been instituted. In November 1995, the Board hired a firm to review the Board's training program. The review consisted of extensive on-site interviews and data analysis, including comparing a sample of parole decision sheets before and after risk assessment training. Following the review's completion, a Corporate Training Plan and National Training Framework were adopted by the Board.
- 35.85 As a result, current training for new members consists of:
- an introductory reading package pertaining to risk assessment and the correctional environment;
- an orientation pretest to determine the participants' threshold knowledge of risk assessment theory and application;
- a 15-day (formerly 10-day) orientation program consisting of classroom instruction, observation at parole hearings and visits to correctional facilities; and
- on-the-job training provided by the Regional Vice-Chair, senior regional staff and experienced Board members.
- 35.86 In addition, all Board members were required to attend a three-day risk assessment course, in 1993–94 and again in 1996–97, that covered the most up-to-date information on theory and application. Since 1995, the Chair has reinstated the three-day annual general Board meetings for all full-time members. They are provided with information and training on advances made in risk assessment research, on criminogenic behaviour and treatment of different types

of offenders, and on lessons learned from previous Board decisions. As well, there are biannual regional training sessions lasting two to three days that target specific training needs identified in the annual performance appraisal process and by other means.

- The Board has developed a 35.87 variety of mechanisms to provide feedback to Board members, including information on successes and failures. Since our audit, the Board has developed a variety of mechanisms for assessing the performance of the Board as a whole. This includes a biannual Performance Monitoring Report that provides yearly data on decision trends, recidivism rates, success rates, rates of return and post-warrant expiry recidivism, by release type, offender risk profile and region. We acknowledge this performance assessment and reporting to be a major step forward from where the Board was in 1994. The Board recognizes, however, that while it is better able to collect and analyze information, it needs to continue to integrate this information into policy and practice.
- Another major form of feedback the Board has implemented since our audit is a performance appraisal system to formally evaluate individual Board members' performance each year. For the purposes of this follow-up audit, we selected a total of five Board member performance appraisals (three full-time members and two part-time members). All of the appraisals followed the established framework and criteria developed by the Board in 1995 and incorporated a critical review of performance. They included examples of strengths and weaknesses as well as plans of action to remedy any weak areas of performance.

**35.89** In 1995, the Board completed a comprehensive review of all reports

Since our audit, the Board has formally evaluated individual Board members' performance each year. concerning offenders on parole who committed further offences (usually violent) with an aim to identify areas that needed to be addressed through policy changes or training. In July 1996, a review of Board policy on inquiries and investigations was completed and new procedures subsequently distributed. In addition, we found evidence that the Board uses the results of investigations as training aids and in the appraisals of individual Board members. In March 1997, for example, a training session on lessons learned was given at the annual general meeting. These were drawn from the experience gained internally through the Board's appeal division case reviews, audit and investigation case reviews, and legal challenges presented to the Board.

35.90 The Board has carried out several reviews of its operations to determine whether it is concentrating its time and effort in the most appropriate areas. In 1995, as part of the government's program and agency review exercise, the Board decided, consistent with the regulations, to reduce the number of members required to render decisions for cases in which there is less risk to public safety. For example, now only one member may be assigned to carry out a

paper decision on accelerated parole review and only two members are required to render appeal division decisions. The Board is considering more changes.

Immediately following the 1994 audit, the Board, with members of Correctional Service Canada, formed a working group to determine the kind of information that the Board needs for decision making and the best format in which to present it to help members make appropriate decisions. This initiative has resulted in the development of the Risk Assessment Report that Correctional Service uses to recommend whether or not parole for an inmate is appropriate. We did not carry out further examination to determine the extent of this new report's implementation. In our November 1996 chapter, Correctional Service Canada -Reintegration of Offenders, we noted that there have been problems in implementing the report. In our follow-up, we plan to conduct a more complete examination of the progress in implementing the Risk Assessment Report and the recommendations pertaining to ensuring that all relevant information is available for decision making.

### **Environment Canada — Managing the Legacy of Hazardous Wastes — 1995, Chapter 2**

Commissioner of the Environment and Sustainable Development: Brian Emmett Responsible Auditor: Wayne Cluskey

#### **Background**

35.92 Our May 1995 audit examined certain aspects of federal management of non-radioactive hazardous wastes; specifically, Environment Canada's management of the remediation of contaminated sites and the storage and destruction of polychlorinated biphenyls (PCBs).

We focussed on Environment 35.93 Canada's management of its responsibilities under the \$250 million joint federal-provincial National Contaminated Sites Remediation Program (NCSRP), which began in 1989-90. The objectives of the five-year program were to ensure the clean-up of high-risk orphan sites in Canada based on the "polluter pays" principle, to promote the development of the Canadian environmental technology industry and to clean up federal sites. We were concerned that when this program ended on 31 March 1995, adequate information on federal contaminated sites did not exist to properly inform Parliament of the health and environmental risks and clean-up costs.

35.94 We also examined the Department's administration of the PCB regulations on use, storage, export and treatment/destruction under the *Canadian Environmental Protection Act*. Under the Green Plan approved in 1990, the destruction of all federal PCBs was to be accomplished by 1996. However, the PCB Destruction Program ended on 31 March 1995 without this task having been completed.

#### **Scope**

35.95 Our follow-up involved reviewing two Environment Canada status reports on actions taken — one report prepared in June 1996 for the Public Accounts Committee and a second prepared in September 1996 at our request.

35.96 We conducted interviews and reviewed supporting documentation as well as other material prepared since the completion of the status reports to further assess the extent of the progress up to our cut-off date of 30 May 1997.

#### Conclusion

**35.97** Although Environment Canada has taken action on many of our recommendations, we remain concerned about a number of recommendations that are taking longer to implement.

#### Observations

Parliament needs adequate information on the risks and clean-up costs of federal contaminated sites

35.98 We reported in the May 1995 chapter that the government did not have adequate information, including an inventory, on federal contaminated sites to determine and to report to Parliament on the health and environmental risks and clean-up costs.

35.99 Since the May 1995 chapter, two committees have been formed — the Contaminated Sites Management Working Group (CSMWG) and the Environmental Accountability Partnership Policy Sub-committee (EAP Sub-committee) —

to develop a common federal approach to dealing with federal contaminated sites.

35.100 The CSMWG committed itself to a workplan, including the task of Site Assessment and Associated Liability. As part of that task, the Working Group developed a definition for contaminated sites and a template to record summary inventory data. In addition, the CSMWG is supporting the Federal Committee on Environmental Management Systems in its efforts to assist with the development of environmental management systems and sustainable development strategies, both of which should contain components addressing contaminated sites. The EAP Sub-committee has developed a draft general policy on contaminated sites, which is currently under discussion; however, it has not established any departmental deadlines, including one for the implementation of the inventory template.

35.101 In Chapter 22 of our November 1996 Report, we looked at departments' progress in identifying, assessing and remediating federal contaminated sites. We concluded that accurate and complete summary data of departmental inventories and estimated costs, both by departments and centrally, will likely not be available for some time. This information is needed to ensure that the high-risk sites posing the greatest risk to public health, safety and the environment are among the first to be remediated.

#### Action plan needed for federal contaminated sites

35.102 The government continues to disagree with us over the need for an action plan to complete the assessment and remediation of all federal contaminated sites; it emphasizes that federal departments are responsible for cleaning up their own sites. The

government states that progress on federal contaminated sites will be accomplished through existing government policies and the CSMWG and the EAP Steering Committee (parent of the EAP Sub-committee). We continue to believe that a federal government action plan is required to ensure that the job gets done within reasonable time frames and to a consistent standard of remediation.

### Disclosure of potential federal environmental liabilities in the financial statements

35.103 Environmental liabilities of the government are likely quite significant and could materially affect the government's reported financial condition. We recommended in our May 1995 Report (Chapter 2) that potential federal liabilities related to the clean-up of contaminated sites that can be determined and reasonably estimated be disclosed in the audited Financial Statements and Annual Financial Report of the Government of Canada. In the last three fiscal years, potential environmental liabilities of \$2.8 billion (an incomplete figure) have been disclosed in the Notes to the Financial Statements and the Annual Financial Report. In the Observations on the Summary Financial Statements, the Auditor General has encouraged the government to quantify at the earliest possible date the full extent of the environmental liabilities, to develop appropriate methodology to distinguish between environmental liabilities and contingencies, and, in the interim, to improve disclosure.

35.104 There has been limited progress on the Auditor General's recommendations in the Observations on the Summary Financial Statements. In Chapter 22 of our November 1996 Report, the Treasury Board Secretariat stated that it "does not expect to issue and implement

a policy before the 1998–99 fiscal year." We understand that the Secretariat is in the process of developing an environmental accounting policy. The draft policy is to be distributed to stakeholders for review and comment in 1997-98 and is to build upon the recommendations of the CSMWG for the consistent recording of information in the inventory of contaminated sites. The inventory is to be based upon the National Classification System for Contaminated Sites issued under the aegis of the Canadian Council of Ministers of the Environment. The assessment process for placing a site in the inventory includes the requirement to estimate the costs of remediation. The Treasury Board Secretariat states that when the assessment process is substantially complete, this inventory will facilitate the quantification of the government's liability for incorporation in the summary financial statements.

35.105 While we have no reason to doubt that the Treasury Board Secretariat will implement a policy by 1998–99, we remain concerned about departmental readiness, given the lack of progress to date.

Treasury Board Secretariat's response: In developing an appropriate accounting policy, the Secretariat is working through an interdepartmental committee that, in turn, is developing a policy for the management of contaminated sites. Through this process, the Secretariat is confident that all departments responsible for contaminated sites will be ready to implement the accounting policy by 31 March 1999.

#### **Destruction of federal PCBs**

**35.106** Under the Green Plan approved in 1990, the destruction of all federal PCBs was to be accomplished by 1996. However, we reported in May 1995 that

achievement of this goal had been impeded due to:

- the failure of Environment Canada to report to Parliament on progress made to date on PCB destruction and to provide a realistic assessment of risks and costs needed to destroy the total federal inventory; and
- the termination of Environment Canada's leadership role in the management of PCB destruction with the end of the PCB Destruction Program at 31 March 1995.

35.107 Since the sunset of Environment Canada's PCB Destruction Program,
Public Works and Government Services
Canada (PWGSC), with support from
Environment Canada, assumed
responsibility as the federal government's
service agent for the collection,
transportation and destruction of all
federally stored PCBs, as well as the
closure of their storage sites. Many
departments and agencies have taken
advantage of the PWGSC services.

35.108 As of January 1997, PWGSC reported that less than two percent of federal PCB waste remained in storage from Environment Canada's original 1995 waste estimate of 5,600 tonnes. Since the May 1995 Report, the number of PCB storage sites has been reduced from 495 (1993) to 227(April 1997). However, the amount of federal PCB waste in storage and the number of storage sites are dynamic. The numbers will change as PCBs come out of service and as PCBs in storage are destroyed. Storage sites are beginning to fill up again with PCBs coming out of service. As well, PWGSC's destruction program has recently been stalled due to difficulties at the Alberta Special Waste Treatment Centre (Swan Hills).

**35.109** PWGSC would like to continue to offer PCB destruction services to

### Follow-up of Recommendations in Previous Reports

federal departments and agencies because of the continuing need and to seek cost efficiencies. As of May 1997, PWGSC senior management was being briefed on the PCB destruction program and options for continuing this service.

35.110 Environment Canada has committed itself to providing a report to Parliament in 1997 that will address the progress made to date on PCB destruction and the risks and costs associated with the remaining federal PCBs. At 30 May 1997, the report had not been drafted, nor was there a target date for its completion.

## Federal Radioactive Waste Management — 1995, Chapter 3

Assistant Auditor General: Maria Barrados Responsible Auditor: Ellen Shillabeer

### **Background**

35.111 Our May 1995 audit assessed whether the federal duties related to responsible management of radioactive waste were clearly defined and assigned. It also covered the related federal government initiatives undertaken and the costs incurred to date, and assessed Canada's progress in those initiatives.

35.112 Since we issued our Report, developments have occurred that move Canada closer to finding long-term solutions for its radioactive waste.

35.113 Natural Resources Canada (NRCan) has developed a policy framework for radioactive waste and has consulted with stakeholders on institutional and financial arrangements for radioactive waste disposal. It has also signed a memorandum of agreement with Ontario to assign responsibilities for decommissioning and long-term management of any "abandoned" uranium mine sites and uranium tailings. The Canadian Environmental Assessment Agency (CEAA) Panel on the Nuclear Fuel Waste Management and Disposal Concept completed its hearings and is developing its recommendations. NRCan has been negotiating for a site for historic low-level radioactive waste and has extended the mandate of the Low-Level Radioactive Waste Management Office.

35.114 This year we followed up on each of the recommendations in our May 1995 Report chapter. We reviewed NRCan's July 1996 status report to the Public Accounts Committee on action taken in response to our recommendations.

Departmental officials provided us with an update on this status report. We discussed ongoing progress, obtained and reviewed supporting documentation and incorporated relevant information into this follow-up report up to 1 September 1997.

### **Conclusion**

35.115 NRCan has taken steps in the right direction to address our audit concerns and to find long-term solutions for Canada's radioactive waste. However, much remains to be done. We recognize that the resolution of some of our concerns requires the involvement and actions of other parties. The Department has been constrained by the CEAA Panel's timetable, the uncertainties of the negotiation process for a site for historic low-level radioactive waste and the large number and various types of stakeholders to be consulted. We will continue to follow up on NRCan's actions and report on them at a future date.

**Observations** 

A policy framework has been developed for radioactive waste

35.116 In July 1996, the Minister of Natural Resources announced the government's approval of a Policy Framework for Radioactive Waste to guide Canada's approach to disposal of high-level (nuclear fuel waste) and low-level radioactive wastes and uranium mine and mill tailings into the next century. The Policy Framework lays out the ground rules for radioactive waste disposal in Canada. It defines the role of government and waste producers and

Although NRCan has taken steps in the right direction, much remains to be done.

owners, and recommends that disposal proceed in a comprehensive and integrated manner. The Policy Framework also sets the context for further development of the financial and institutional arrangements.

35.117 In October 1996, NRCan issued a discussion paper to seek stakeholder views on the federal oversight role, on how the stakeholders would organize for waste disposal and on how they propose to fund disposal programs. At the time of our follow-up, the Department had received feedback, but indicated that it will wait for the CEAA Panel's recommendations before continuing work on the institutional and financial arrangements.

### Decision on a long-term solution for nuclear fuel waste awaiting results of the CEAA Panel

35.118 No decision has been made on how to proceed with a long-term solution for managing nuclear fuel waste. In March 1996, the CEAA Panel on the Nuclear Fuel Waste Management and Disposal Concept began a three-phase public hearing process on the Atomic Energy of Canada Limited's concept of deep geologic disposal of nuclear fuel waste. The Panel finished its hearings in March 1997 and is expected to submit its recommendations on the safety and acceptability of the disposal concept to the Minister of Natural Resources and the Minister of the Environment in early 1998. Any response by the government will be made only after consideration of both the Panel's recommendations and stakeholders' views from the Policy Framework consultations.

## Negotiations continue on a disposal facility for historic low-level radioactive waste

35.119 The federal government set up a task force to make recommendations on the long-term management options and to identify possible disposal sites for historic low-level radioactive wastes. In July 1995, the Siting Task Force and the Town of Deep River signed a Community Agreement-in-Principle (CAP) that set out the terms and conditions for a proposed facility for the disposal of low-level radioactive waste in Deep River. A condition in the CAP was that the agreement had to be converted into a contract before 31 December 1996. Following community endorsement of the CAP in September 1995, the federal government announced its intention in July 1996 to proceed with negotiations with the Town, However, during negotiations it did not accept some of the conditions in the CAP; thus a contract between the two parties was not reached by 31 December 1996. In early 1997, the Minister of Natural Resources and the Mayor of the Town exchanged letters in an attempt to continue discussions. Negotiations based on a new set of conditions got under way in July 1997. If a legal agreement is struck, the appropriate review and licensing will be required.

## Mandate of Low-Level Radioactive Waste Management Office has been extended

35.120 In March 1995, the federal government extended by five years the mandate of the Low-Level Radioactive Waste Management Office, the federal agent designated for cleaning up historic low-level radioactive waste. This action provides the required continuity in federal

responsibilities for the management of Canada's historic low-level radioactive waste and addresses our recommendation.

AECB has initiated action to license the pre-1976 uranium mines and tailings sites

35.121 The Atomic Energy Control Board has corresponded with current owners of the 11 pre-1976 tailings sites to invite them to complete and submit an Application for Prescribed Substance Licence. One site is now under AECB licence, and negotiations are taking place with the owners of the other sites concerning possible licensing of their sites. AECB expects to have most pre-1976 tailings sites licensed by 1998.

**35.122** AECB believes that none of the pre-1976 tailings sites represents an immediate threat to health, safety or the environment but that appropriate steps must be taken to ensure their long-term acceptability.

Decommissioning and long-term management responsibilities of any "abandoned" uranium mine sites and uranium tailings are resolved for Ontario

35.123 In January 1996, the Minister of Natural Resources signed a Memorandum of Agreement with the Ontario Minister of Northern Development and Mines on the cost sharing of any decommissioning activities and on the long-term management responsibilities needed for any "abandoned" uranium mine sites and uranium mine tailings in the province. Although this agreement applies only to sites in Ontario, it represents most of the estimated decommissioning costs for all uranium mine sites and uranium tailings in

Canada that are or could potentially be abandoned.

**35.124** NRCan officials have discussed with Saskatchewan officials the possibility of a similar initiative for their province.

NRCan and AECB have a common understanding about the underlying assumptions of volumes and cost data

35.125 NRCan and the AECB have reached a common understanding about the underlying assumptions that resulted in differences in estimates of volumes and costs for the decommissioning of uranium tailings. The data were reconciled during the joint effort of NRCan, AECB and Ontario in developing the Memorandum of Agreement discussed in paragraph 35.123.

Disclosure of potential federal environmental liabilities in the Notes to the Financial Statements includes liabilities for radioactive waste

35.126 Our May 1995 chapter estimated that the potential federal liabilities related to finding solutions for radioactive waste totalled approximately \$850 million. We recommended that those potential federal liabilities related to radioactive waste that can be determined and reasonably estimated be disclosed in the Notes to the Financial Statements and in the Notes to the Annual Financial Report of the Government of Canada. In the last three fiscal years, the potential federal environmental liabilities for both radioactive and non-radioactive waste, although an incomplete estimate, have been disclosed in the Notes to the Financial Statements and in the Notes to the Annual Financial Report. For further details, refer to paragraphs 35.103 to 35.105 in this chapter.

## Industry Canada — Business Assistance Programs in Transition — 1995, Chapter 14

Assistant Auditor General: Richard Flageole Responsible Auditor: Peter Simeoni

### **Background**

35.127 Our 1995 audit focussed on business assistance programs. We selected for audit four financial assistance programs, support to tourism and the Canada Business Service Centres initiative.

35.128 During our audit, the government announced that it was terminating a number of programs including almost all those that we had selected, such as the Sector Campaigns and the tourism sub-agreements. Tourism Canada was wound up but was replaced by the Canadian Tourism Commission in January 1995. Only the Business Service Centres remain today.

35.129 We recognize that Industry Canada's programs have been modified considerably and that, moreover, there is a considerable reduction in the grants and contributions budget of the Department. However, we believe that the recommendations formulated in our 1995 chapter are still relevant. On the one hand, Industry Canada must continue to pay attention to its old programs. Even though they have been terminated or wound up, they are still making payments to businesses that will be repayable to the government over a number of years. On the other hand, the good management principles we recommended also apply to the new contribution programs managed by the Department.

**35.130** Our follow-up consisted of a review of the Department's reports on its progress in response to our 1995 recommendations. We also examined

supporting documentation and held discussions with the responsible managers.

### Conclusion

35.131 The Department has generally taken satisfactory steps to respond to our 1995 recommendations. However, we cannot yet fully assess the initiatives taken to improve project evaluation procedures, since these are part of a new program, Technology Partnerships Canada, which we have not audited. We will take this fact into account when developing plans for future audits.

### **Observations**

### Financial contributions programs

**35.132** Repayment for terminated programs. During our 1995 audit, we asked who was responsible for the repayment of contributions under terminated programs now that the project officers who had been dealing with businesses in the regions no longer handled projects. As there was no one responsible, we recommended that the Department clearly assign responsibility for monitoring and verifying repayment of contributions.

**35.133** Following the 1995 Budget, Industry Canada decided to centralize program delivery in Ottawa. A program and repayment section was established in the fall of 1995 to handle repayments for almost all terminated programs.

**35.134** Departmental representatives indicated to us that the policy and operational improvements made during 1996–97 were instrumental in convincing

businesses that the Department is serious in its efforts to ensure repayments of contributions. For example, businesses that are awarded new contributions under other departmental programs must first repay any amounts they owe before receiving additional payments. The representatives also informed us that additional improvements are being made. They recently put into place a program to audit the sales reports of businesses, to ensure the accuracy of the sales figures on which the royalties owing are calculated. According to the Department, \$69 million was recovered in 1996-97, which represents twice the historic average of past years. The Department hopes to collect \$74 million in 1997-98.

#### **Assessment of applications**

35.135 Since the programs audited in 1995 no longer existed at the time of our follow-up, we decided to turn our attention to the Technology Partnerships Canada (TPC) Program. We looked at the process established under the new program for assessing funding applications.

35.136 Technology Partnerships Canada is a special operating agency that was established in March 1996. Its budget is \$200 million for 1997–98. By making contributions available to the private sector, Industry Canada shows that it wants to share the risks with private industry, but also to profit from its investments.

35.137 Unlike previous programs, all project decisions are reviewed by the Program Services Directorate. This section is separate from the decision-making process and reports to the Executive Director. We believe that the establishment of a separate unit to handle quality control within TPC should help

respond to the observations in our 1995 Report. However, the limited work carried out as part of the follow-up does not permit us to make more detailed comments on this subject.

### Direction of government assistance programs

35.138 In 1995, we recommended that Industry Canada ensure that its application of the policy on repayable contributions is consistent with the intent of the policy to orient government assistance programs more toward investment than subsidization. The vast majority of the contributions paid out under programs that we audited were not repayable.

35.139 In February 1996, the Program and Service Board approved changes to the departmental policy, limiting situations where contributions are no longer repayable. These changes included the elimination of the \$100,000 threshold, below which contributions were rarely repayable. The policy also states that possible exemptions are no longer generally applicable but are instead to be used only when fully justified. We are satisfied with the actions taken by the Department to amend its policy.

#### **Canada Business Service Centres**

35.140 The Canada Business Service Centres (CBSCs) network comprises 12 centres, one in each province and territory. The primary role of the centres is to provide, under a single roof, all available information required to respond to the needs of businesses. There is a National Secretariat whose main function is to provide centralized support to the network of regional centres and to facilitate the development of the CBSC initiative. Among other things, it is responsible for providing and updating federal information for the network.

35.141 In 1995, we recommended the development of a common vision, national guiding principles, and a limited number of basic service standards. In February 1996, the CBSC Committee of Managing Partners approved a vision statement for the CBSC initiative. That document set out the mission, guiding principles and service standards for the CBSC network. The next phase involved applying the standards throughout the network.

35.142 We believe that there is still work to be done on the publication of standards. Only two CBSCs had published their service standards on the Internet at the time of our follow-up. Departmental representatives informed us that a CBSC Internet Working Group is currently developing national service standards to be added to the CBSC main Web site.

35.143 We noted in 1995 that the information given on certain programs was out-of-date or inadequate in some cases. We recommended that the Secretariat help the CBSCs to resolve these problems. As a result, standards for the quality and timeliness of federal information have been used by the National Secretariat since April 1996. They involve monthly updating of the most frequently used 20 percent of federal information and updating the remaining information within a period of not more than six months. There is a system to track the number of times users access information about each program on the Internet. The National Secretariat is planning to extend the compilation of data by incorporating inquiries from sources other than the Internet. According to departmental representatives, the Secretariat maintains frequent contact with its partners and monitors all government announcements to identify new programs.

### Travel and Hospitality — 1995, Chapter 7

Assistant Auditor General: Doug Timmins Responsible Auditor: Hugh McRoberts

### **Background**

**35.144** Our 1995 chapter focussed on the management of public service travel spending by departments and agencies. We recommended that the Treasury Board Secretariat:

- consider providing public information on travel;
- pursue the implementation of automated travel systems and help specify the information needed to manage travel better:
- assess and further clarify the application of policy for business-class travel and travel bonus points;
- consider publishing principles of behaviour in government travel; and
- assess possible changes to the Travel Directive and Travel Guide.

35.145 In addition, we recommended that Public Works and Government Services Canada (PWGSC) develop better ways of measuring the use of travel and progress toward a goal of least-cost travel.

### **Scope**

35.146 Our follow-up was limited to reviewing status reports prepared by both the Treasury Board Secretariat and PWGSC in August 1997 on the actions taken to address the 1995 recommendations. We also reviewed supporting documentation and conducted interviews to discuss and assess actions taken.

### Conclusion

**35.147** Both the Secretariat and PWGSC have initiated action to address the recommendations that we raised in 1995. Work remains to be done in some areas.

35.148 Work is continuing on the development of an improved Travel Expert System that can be used by managers and travellers to reduce the cost of travel administration and provide better information for improved accountability.

35.149 The Secretariat cannot unilaterally change the Travel Directive, and discussions are ongoing with employee unions to address the terms and conditions of the Directive. Reduction of administrative costs and improved technology and systems are the goals of the Secretariat throughout these negotiations. The impact of initiatives that may result from these negotiations is not known at this time.

35.150 The current travel service contract expires 31 December 1997. PWGSC has indicated that the new contract will focus on service to clients and reducing costs through the use of technology. As the final contract had not been awarded at the time of our follow-up, we are not yet able to assess the impact of this initiative.

### **Observations**

#### Public information on travel

**35.151** The Treasury Board Secretariat still does not believe there is a need to develop a government-wide report on travel. According to the Secretariat, the information is not available and

departmental coding is not set up to accommodate this request.

#### **Automated travel systems**

35.152 Work is in progress to update the current DOS-based Travel Expert System to a Windows and Internet environment. This would reduce the technical support requirements of the users, reduce costs, provide better travel information and be an important step to achieve client acceptance of this system. Also, a new automated management reporting system, "Reportlink", has been installed in over 240 locations across government. It is a PC-based relational database system that has replaced the use of extensive hard-copy standard reports.

### Business-class travel and travel bonus points

35.153 The Treasury Board Secretariat has reviewed the business-class travel policy and believes that it is carefully defined in the Travel Directive and applies to the majority of public servants. The Secretariat is reviewing the current policy on travel bonus points, in conjunction with the new Request for Proposal described below.

### Publishing principles of behaviour for government travel

**35.154** The Secretariat believes that books on ethics, values and behaviour, if developed, should not be directed at one isolated aspect of government expenditure (travel) but at conduct in general expected of public servants.

### Changes to the Travel Directive and Travel Guide

**35.155** It is the intent of the Treasury Board Secretariat to revise the Travel

Directive, with the goal of reducing the administrative costs of travel, and to recognize the importance of improving technology and systems. The Travel Directive is a National Joint Council agreement that forms part of employees' collective agreements.

35.156 Proposals for changes to the Directive require agreement by public service unions, and discussions on those proposals have commenced. The Travel Guide is a tool used to explain the Directive and it should reflect, in a timely manner, changes made to the Directive.

### Measuring the use of travel toward a goal of least-cost travel

**35.157** PWGSC has taken the following measures to address our recommendation:

- A new automated travel management reporting system, "Reportlink", was implemented across 68 government entities and provides standard, as well as customized, travel reports to meet clients' specific needs.
- Random reviews of airfares were introduced.
- A new Low Fare Guarantee process was negotiated with the current Government Travel Service contractor in April 1996.
- As the current contract expires in December 1997, PWGSC issued a Request for Proposal (RFP) for a new travel service contractor in July 1997. The RFP aims at maximizing service to travellers, reducing costs through the use of technology (for example, automated booking) and providing a distinct international service. The RFP is based on a fee-for-service regime, which will enable the government to negotiate preferred airfares with air carriers.

## Atlantic Canada Opportunities Agency — 1995, Chapter 18

Assistant Auditor General: Don Young Responsible Auditor: John O'Brien

### **Background**

35.158 In 1995, we recommended that the Agency improve the measurement and reporting of the results achieved by its programs, including improving the clarity and measurability of objectives for key programs and the techniques used in program evaluations. We noted problems with the input and assumptions used in the econometric modelling exercise used to evaluate the Action Program. In addition, we recommended that the Agency ensure that its results measurement distinguish clearly between actual and projected results. We suggested that for COOPERATION agreements, information on recipients, activities and results should be maintained in a consistent form that is readily accessible.

35.159 We recommended that, during the project approval process, the Agency ensure that expected project results are specified and clearly linked to the objectives of the programs. The risks of projects not achieving their goals needed to be considered in the type of assessment procedures employed. We also had concerns about the adequacy of monitoring of project progress and results.

35.160 Since the 1995 audit, the Agency has replaced one of its major programs, the Action Program, with the Business Development Program. In addition, the Agency has implemented the government's policies covering the repayability of support to business.

### Scope

35.161 Our 1997 follow-up work involved reviewing the Agency's status report on progress in implementing the recommendations. Our conclusions are based on interviews with Agency officials and a review of documents provided to us by the Agency, including the changes to its policies and procedures for project management and decision making.

### Conclusion

#### Measuring and reporting results

35.162 Since 1995, the Agency has undertaken various performance measurement initiatives. We noted that in its 1996 Performance Report to Parliament and the 1997–98 Main Estimates, the Agency identified six strategic priorities, with performance indicators that were stated in clear and measurable terms. Subsequent results measurement will be against these performance indicators. According to the Agency, program initiatives or projects must, as a minimum, meet one of the strategic priorities or the overall Agency mandate of increased employment and earned income.

35.163 The Agency has made progress in improving some of its results measurement and reporting processes. The 1996 Performance Report to Parliament clearly indicates what results are being reported and the means by which those results are being reported. However, we did not audit the information presented to us by the Agency; therefore, we were unable to determine whether the Agency has made improvements in the

The Agency has made some progress in improving some of its results measurement and reporting processes.

The processes used for measuring results of the COOPERATION Program remain largely unchanged from 1995.

The Agency has made progress in improving its project management and decision making for the Business
Development Program.

There has been an apparent lack of emphasis on program evaluation in favour of performance measurement.

measurement of the numbers of jobs created and maintained. The processes used for measuring results of the COOPERATION Program remain largely unchanged from 1995. Further, the program objectives for both the Business Development and COOPERATION programs remain broad, making subsequent program evaluation difficult.

### Project management and decision making

35.164 The Agency has made progress in improving its project management and decision making for the Business Development Program. It is in the process of changing its monitoring procedures. In the one region that is taking the lead on this initiative, we noted that the monitoring of projects was based on the risks associated with the effective implementation and attainment of the project objectives. This is consistent with the intent of our recommendations. In this initiative, account managers are expected to have an understanding of client operations and the progress and results of projects. There has been less progress in changes to project management and decision making for the COOPERATION Program.

### **Observations**

### Measuring and reporting results

35.165 Since completing the program evaluations of the Action and COOPERATION programs, the Agency has moved toward developing ongoing performance measures. It has changed its approach to performance measurement by measuring results against six strategic priorities rather than against individual program objectives. For the most part, the performance indicators developed for these strategic priorities are stated in clear and measurable terms.

35.166 Our review of the studies that support the performance measures reported in the Agency's 1996 Performance Report to Parliament and the 1997-98 Main Estimates found that the Agency has attempted to address the concerns raised in our 1995 audit. Without conducting an audit of the information presented to us by the Agency, we were unable to determine whether the Agency has made improvements in the measurement of the numbers of jobs created and maintained. In its econometric modelling exercise, which converts the number of jobs created and maintained into the total economic impact on the Atlantic economy, the Agency continues to use the assumption that all of the jobs created by the program will last for a period of 10 years. As in 1995, we were not able to find support for this assumption.

35.167 The Agency has recognized some of the inherent difficulties associated with the use of a client survey as the primary source of results information. To address this matter, the Agency is in the process of establishing a benefit monitoring program. This program is designed to ensure that Agency staff actively monitor key expected results, such as jobs created and maintained, for a sample of Agency projects and thereby provide an estimate of the results achieved for all of the Agency's program activity. These results will be corroborated through ongoing client surveys. We believe that these planned changes could greatly benefit the results measurement processes of the Agency if they are implemented appropriately.

**35.168** The evolution of the Agency's performance measurement practices has occurred at a time when several important program changes, such as repayability of assistance to business, have been

implemented. There has been an apparent lack of emphasis on program evaluation in favour of performance measurement. Although the latter is a very useful tool, it is not a substitute for program evaluations that provide assessments of the rationale for programs, the impacts and effects that can be attributed to them (including their success in achieving program objectives) and the cost-effectiveness of alternative means for achieving objectives. In this context, we note that the objectives for both the new Business Development and the COOPERATION programs remain very broad, which will make it difficult for future program evaluations to assess the extent to which objectives have been met.

### Project management and decision making

35.169 The Agency has put considerable effort into changes in its assessment processes for the Business Development Program. The 1995 audit found that projects were screened based only on the size of a project. The assessment procedures now call for risk analysis based on the key economic development factors (such as viability, incrementality and net economic benefit), as well as on project size.

35.170 The Agency has indicated that two of its regions are employing new means of monitoring Business
Development Program projects. For the one process that we reviewed, the monitoring of projects was based on the risks associated with effective

implementation (for example, financial and human resources available to support the project) and the attainment of the project objectives. Account managers are expected to have an understanding of client operations and the progress and results of projects based on the risks associated with the project.

**35.171** The COOPERATION Program now funds only non-commercial projects. Thus, the Agency considers the individual eligibility criteria for COOPERATION agreements to be more relevant than the key economic development factors mentioned earlier. While the Agency has moved to streamline the number of COOPERATION agreements with individual provinces, agreement objectives are still not stated in a clear, measurable and results-oriented manner. The Agency has indicated that it will monitor COOPERATION projects through the benefit monitoring program in the future. Results measurement will be through program evaluation of individual agreements and surveys. With the exception of the planned implementation of the benefit monitoring program, the assessment and monitoring processes used by the Agency are not significantly different from those found in the 1995 audit. The Agency had developed the means to acquire information on recipients and activities for COOPERATION agreements. Recently, it has had to revise its approach to information gathering because of systems changes on the part of several of its provincial partners.

The assessment and monitoring processes for the COOPERATION Program are not significantly different from those found in the 1995 audit.

# Federal Office of Regional Development—Quebec — 1995, Chapter 19

Deputy Auditor General: Michael J. McLaughlin Responsible Auditor: Micheline Ethier Massicotte

### **Background**

**35.172** At the time of our audit in 1995, the Federal Office of Regional Development-Quebec (FORD-Q) had begun implementing its new program, which consisted primarily of the IDEA-SME program. This program differed significantly from the previous program, which had focussed on financial assistance for capital projects. IDEA-SME provides small and medium-sized businesses in Quebec with an integrated package of financial and non-financial services, such as the distribution of strategic information and advisory services. Financial support is now considered an extension of non-financial services and focusses more on the funding of activities such as market studies and participation in seminars or trade missions.

35.173 Our 1995 chapter highlighted a number of major challenges that FORD–Q would have to meet in order to successfully implement its new program and achieve the expected results. We also made a number of observations and formulated recommendations on the delivery of financial assistance programs, ongoing performance measurement and program evaluation.

35.174 Our follow-up work consisted primarily of discussions with representatives from the Department regarding measures taken in response to our recommendations, and a review of the supporting documents. We did not attempt to evaluate the measures taken.

### Conclusion

35.175 FORD—Q has acted on all our recommendations. It has begun to meet all the challenges relating to the implementation of its new program, but progress regarding the delivery of financial services has been slower. Nevertheless, it has achieved considerable progress in the area of results-oriented management.

35.176 However, there is still much to do. A large number of measures have been implemented recently or will be over the course of the next year. The Department will need to persevere in its efforts to bring to completion all the projects that have been initiated.

35.177 The measures taken over the last two years demonstrate a willingness to put into place mechanisms that will help bring about a performance-oriented management culture. Changing management methods and attitudes takes considerable work. It will therefore require a great deal of time and a sustained effort to ensure the success of this initiative.

### **Observations**

The challenges of implementing the new program

35.178 Since our 1995 chapter, the Department has clarified its objectives and priorities. It has established a structured annual planning process that includes communicating the Deputy Minister's objectives and priorities, preparing business plans by each responsibility centre and determining expected results.

FORD-Q has acted on our recommendations. However, it will need to persevere in its efforts to bring to completion all the projects that have been initiated.

The planning process has greatly improved over the past two years. However, the Department will need to carry out a more rigorous follow-up of its business plans in order to compare the expected results with those that were actually achieved.

35.179 FORD—Q is currently reviewing its activities and services in the light of the past two years' experience, with a view to specifying them and determining the most efficient delivery methods. In our opinion, the Department needs to take advantage of this opportunity to update the management framework for the IDEA-SME program in order to ensure that its objectives, priorities, services and conditions remain relevant.

35.180 Computerized systems. During our follow-up, we noted that FORD-Q had experienced problems with the installation of two computer systems that are important to the smooth operation and sound management of the program. These were the system used to deliver services and collect data on results achieved (AIDER) and the financial information and contribution management system (G-MAX).

35.181 In the area of program operation, the delivery of non-financial services could be improved, especially in the provision of strategic information and advisory services. Accessing the information is difficult because the computer equipment is not powerful enough. To overcome these deficiencies, the Department has taken a number of steps over the past year. It has added to its computer infrastructure, determined the equipment requirements for its regional offices and begun the process of acquiring equipment. However, it has experienced difficulties in fine-tuning the AIDER

system, and this has resulted in several delays in implementation since 1995–96. It is now expected to come on-line by the spring of 1998. The Department appears to have taken the appropriate steps to avoid additional delays and problems, by developing an implementation plan and carrying out periodic follow-up.

35.182 The expectations of management and staff for the AIDER system are very high because of its importance to the efficient delivery of services and the improvement of management information. In light of the considerable sums invested to date to get the system up and running and the difficulties experienced in the past, departmental management will need to continue giving special attention to the implementation of this system. Among other things, management needs to ensure that the required computer equipment is in place at the proper time, that users receive adequate training and that appropriate controls are in place to ensure the accuracy and completeness of the information.

35.183 With respect to program management, FORD-Q has set up a number of mechanisms and systems to manage activities related to IDEA-SME but management does not have available complete and regular management information. In 1995, FORD-Q replaced its contribution management system and experienced various difficulties in extracting data and preparing reports. These problems seem to have been resolved now. Further, the lack of non-financial services data in the system and delays in implementing AIDER have meant that management until now has received little information on the provision of strategic information and advisory services.

The Department needs to take advantage of the review of its activities to update the management framework for the IDEA-SME program.

FORD-Q experienced problems with the installation of two important computer systems.

FORD-Q has gone to considerable effort in responding to our recommendations on the evaluation of results.

### The criteria used in analyzing projects remain general

35.184 The IDEA-SME management framework, as it was designed, allows activities and services to be tailored to meet the needs of clients in the Quebec regions. After two years of delivering financial services, the Department has noted a lack of uniformity in the way the procedural requirements for the program have been interpreted and in the thoroughness with which projects have been evaluated. It has already initiated a number of projects, specifically the phasing in of ISO 9002 certification for all the regional offices (designed to standardize all steps in the delivery of services), and the establishment of a program policy council and working committees to study specific aspects of the program. A study is also under way to identify the procedural requirements and analysis criteria used throughout the regional office network. In our view, the Department needs to use the results from these studies to harmonize its procedural requirements and set out analysis criteria for projects based on the features of the project in question: its nature, the applicant and the amount of assistance involved

35.185 The Department has taken a first step in determining its risk by setting a range for the loss rates on its repayable contributions, although this range is quite broad (between 35 and 50 percent). The Department needs to specify to a greater degree its expectations in this respect and ensure that project analysis takes into account the possibility of recovering the contributions.

### Important steps toward results-oriented management

**35.186** FORD–Q has gone to considerable effort in responding to our

recommendations on the evaluation of results. It has developed a performance management framework that is applied throughout the Department and that links its mission to its programs and activities and to the impacts that they will have. This overall framework is currently used as a basis for developing performance measurement frameworks for all the Department's activities. The framework for the IDEA-SME program is ready and complete, and the performance indicators are reasonable at this time. The Department plans to gather data on an ongoing basis and to assess the program periodically. At the present time, the continuous collection of data is not a current practice of the Department. The Department is relying heavily on the implementation of the new AIDER system to facilitate this change and to distribute management information using a computerized key performance indicator panel. In addition, the Department has developed a course on performance measurement and evaluation that has been offered to a small group of persons so far. Continuing this initiative should help communicate to staff the importance of measuring performance and results.

35.187 An evaluation policy was to be approved by the fall of 1997. The Department has conducted evaluations of a number of its programs since our audit. We have noted improvements in that both negative and positive consequences have been examined, thereby providing a balanced picture of the effects of the programs that are being evaluated.

35.188 As well, the Department is now presenting performance information in its Part III Estimates, which constitutes an important addition. However, improvements are still required. The reader now sees data but these data are not linked to any pre-established objectives.

The reader is therefore unable to judge whether or not the results are acceptable.

**35.189** These initiatives require a major cultural change and a long-term effort in order to ensure success. It is too early to conclude that FORD–Q is in a position to

analyze the results of its programs and make decisions based on the results obtained. However, the elements that have been put in place reflect major progress toward the implementation of results-oriented management.

# Western Economic Diversification Canada — 1995, Chapter 20

Assistant Auditor General: Don Young Responsible Auditor: Roger Simpson

### **Background**

35.190 Our 1995 audit focussed on the Department's then Western Diversification Program, a program providing financial assistance to business that was designed to diversify Western Canada's economy. We also audited related issues such as collection of repayable assistance, how the Department measures and reports the results of programs, and the roles of the Department's headquarters in Edmonton compared with its Ottawa office.

when the Department had many activities, but its Western Diversification Program was its primary focus. By the completion of our audit, the Program's termination had been announced. Consequently, wherever possible, our recommendations focussed on future programs and the challenges of administering the Western Diversification Program as a significant "legacy" program where both payments for previously approved assistance and collections of repayable assistance would continue for years.

35.192 Our follow-up involved reviewing Western Diversification's status report on action taken. We also reviewed supporting documents and conducted interviews to discuss and assess the extent of progress.

The Deputy Minister's office will be located in Edmonton effective 1 November 1997.

Decisions on how to

address most of our

recommendations will

be made by the fall of

1997.

### Conclusion

35.193 The Department has taken steps to begin to respond to our recommendations; however, progress to date to address them fully has been slow. To a large extent, this is due to the

fundamental changes in programs and structure that the Department has experienced over the last two years. Departmental management estimates that decisions on how to address most of our recommendations will have been made by the fall of 1997.

### **Observations**

### Organizational design

35.194 At the time of our audit, Western Diversification had offices in Ottawa and each of the four Western provinces, with central support services in Ottawa. The Department's enabling legislation requires its principal office to be in Edmonton, Alberta. In 1995 we were concerned that there was no analysis by the Department to demonstrate that the staff levels at each location (such as having support staff in Ottawa for a western-based Department) were economical.

35.195 The Department indicated, at the time of our audit, that an examination of administrative functions then under way would help to address our recommendation. The Department more recently indicated that the Deputy Minister's office will be located in Edmonton effective 1 November 1997, and that the future design of the Department should be finalized by the fall of 1997.

### Collecting repayments from legacy programs

35.196 Western Diversification's new directions take it away from providing direct financial assistance to business. However, it will have to continue to

administer collections under a number of legacy programs, the most significant of which is the Western Diversification Program. The Department estimates that its 1997–98 collections from legacy programs will be \$49 million, declining to \$28 million by 2000–01.

35.197 In 1995 the Department used a combination of its own and full-time contract staff to collect repayments. We recommended that the Department seek ways to minimize collection costs. The challenge remains to collect repayments in a cost-effective manner.

**35.198** The Department has considered three collection options:

- 1. continue to collect repayments internally;
- sell the portfolio, or have a third party collect it on the Department's behalf;
- 3. use some combination of the two.
- 35.199 The Department rated the collectability of the portfolio, and had informal discussions with third parties with potential interest in the portfolio. Ultimately, the Department decided to negotiate with Revenue Canada, with a view to having it collect repayments on Western Diversification's behalf. Discussions on the matter are continuing.

**35.200** As the Department has apparently decided to move to third-party collection of repayments, it needs to finalize the collection arrangements.

### Performance measurement and reporting

**35.201** General observations. We made a series of recommendations concerning how Western Diversification should establish objectives for its programs, measure their results, and report results to Parliament and others.

35.202 Since 1995, performance reporting in government has assumed a higher profile with the new annual report by the President of the Treasury Board. This report focuses on the importance of measuring and reporting the results of government programs, on individual performance reports by 16 pilot departments and agencies in fall 1996, and on performance reports by all departments including Western Diversification in the fall of 1997.

35.203 Western Diversification faces the challenge of having to assess the performance of a new portfolio of programs. Furthermore, many of these new programs are delivered by third parties on the Department's behalf, which can complicate the process.

35.204 We reviewed a number of departmental documents to determine the Department's readiness to measure and report performance, and guidelines prepared by its Audit and Evaluation Branch that provide a basis for that effort. Other documents, such as a draft Service Partnerships Business Plan and a report on corporate realignment, contribute to its readiness.

**35.205** Overall, the Department is moving toward strengthening its capacity to assess and report on performance, but actual performance measurement and reporting activities to date have been few. In our view, however, given the fundamental changes in the Department's programs over the last two years, progress has been reasonable.

35.206 Procurement advocacy. Our 1995 Report also made specific recommendations concerning the Department's reporting of its efforts in advocating the procurement interests of Western Canada in the government's major Crown projects. The Department had reported quantitative information on

### Follow-up of Recommendations in Previous Reports

the West's increase in the share of the "industrial regional benefits" from major Crown projects since Western Diversification's inception.

35.207 We recommended a fuller discussion elaborating on quantitative measures, and enhancing the methodology used to measure and report the benefits of procurement advocacy. Subsequent to our recommendation, Western Diversification ceased publicizing this type of

information. Currently, a group of departments involved with procurement are participating in an overall evaluation of the government's industrial regional benefits policy. The evaluation is led by Industry Canada in two phases, with completion of phases one and two planned for fall 1997 and spring 1998 respectively. When completed, the evaluation will presumably allow Western Diversification to report better information on the results of its procurement advocacy efforts.

## Industry Canada — Regional Development Programs — 1995, Chapter 21

Assistant Auditor General: Richard Flageole Responsible Auditor: Peter Simeoni

### **Background**

35.208 In 1995 we examined both of the federal regional development programs for which Industry Canada is directly responsible: the Federal Economic Development Initiative in Northern Ontario (FedNor) and the Canada–Quebec Subsidiary Agreements on Industrial Development.

**35.209** Our follow-up work consisted of a review of the Department's reports on its progress in response to our 1995 recommendations. We also reviewed and discussed supporting documentation with the responsible managers.

### Conclusion

**35.210** We found that the Department has made satisfactory progress in addressing the recommendations we made in 1995.

#### **Observations**

#### FedNor

35.211 The Federal Economic
Development Initiative in Northern
Ontario (FedNor) was created in 1987 to
address the economic disparities and
adjustment problems of the region. In
1992 FedNor was extended for five years
and the various financial assistance
programs were replaced by a single
program, the FedNor Business Incentives
Program. However, following
consultations, in March 1996 the
government announced a restructuring of
the program. FedNor received a new
three-year mandate and a budget of

approximately \$60 million. Its strategy covers the following four components: improving access of small businesses to capital, to information and to markets, and promotion of community partnerships. Since the FedNor component audited in 1995 dealt with financial programs, our follow-up focusses on programs for access to capital.

35.212 Program management. In 1995 we recommended development of a streamlined set of guidelines and criteria for assessing applications, differentiated by their size and risk. We also recommended that application documentation be simplified, especially for small projects. Since the restructuring, FedNor now works through partnerships with stakeholders such as financial institutions, community development corporations and the private sector.

35.213 Assistance provided to businesses takes two forms: contributions and loan/investment fund loss reserves. Programs are available both for private companies and for community organizations. FedNor has also set up a number of programs to meet the needs of certain target groups. Accordingly, we are satisfied with the efforts made by FedNor to better segment clients according to their needs.

35.214 Monitoring of projects. We recommended establishment of clear guidelines for monitoring project performance and for reporting project results in the final project report. In view of the creation of new programs and the use of new program delivery mechanisms, we believe it is still too early to determine

whether FedNor is adequately monitoring its projects.

35.215 Performance and program evaluation. The recent development of an evaluation framework for the FedNor Business Incentives Program has addressed the recommendation we made in 1995. Management has informed us that it will begin collecting information identified in the evaluation framework to assess performance in late autumn 1997.

### Canada-Quebec Subsidiary Agreements on Industrial Development

35.216 The two Canada–Quebec subsidiary agreements were established to co-ordinate industrial development measures of the Government of Quebec and the federal government. The agreements, signed in 1985 and 1992, were to expire on 31 March 1997. In May 1996, it was decided to extend the expiry date by one year. At the same time, the two agreements were merged under the terms and conditions of the second agreement. The few existing projects approved under the 1985 agreement continue to be governed by the terms of that agreement.

35.217 As a result of cuts and other adjustments, federal funding authorized under the two agreements now amounts to nearly \$350 million. At the time of our follow-up, the government had committed nearly all of its funds.

**35.218 Documenting support for decisions.** In 1995, we looked at documentation in support of funding decisions. We found cases where there was little analysis of key issues. In view of the large sums invested, we recommended that the Department ensure that decisions to fund projects are supported by persuasive assessments in project files.

35.219 Shortly before our audit, Industry Canada was assigned responsibility for managing both of the subsidiary agreements. It had assumed this responsibility previously, from 1985 to 1991, when the Federal Office of Regional Development–Quebec (FORD–Q) took it over.

35.220 Industry Canada has added another level to the project approvals process. This level, the Program and Service Board, is a compulsory step for major projects undertaken under the various departmental programs. The Board, made up of senior departmental officials, is responsible for ensuring that certain specific elements have been examined before approval is given.

35.221 In its July 1997 progress report, Industry Canada stated it is continuing to ensure that arguments in support of the funding recommendations are clearly documented in project files. Departmental representatives told us that the Board's concerns are taken into consideration when the recommendation for project approval is being prepared. Our review of a small sample of files suggests that the documentation supporting project funding recommendations has improved.

**35.222** Evaluation of the subsidiary agreements. During our audit, we noted that the first agreement had been renewed and the second agreement signed without a full evaluation of the first agreement having been conducted. We recommended that the Department complete an evaluation of both subsidiary agreements.

35.223 In autumn 1995, the Management Committee responsible for the subsidiary agreements agreed to conduct a joint evaluation of the two agreements in 1996–1997. The evaluation was assigned to a private sector company that was to present a first draft by 31 March 1997. At the time of our follow-up, the final version

of the evaluation was about to be approved by the federal and provincial members of the Management Committee. **35.224** Even if the Canada–Quebec agreement is not renewed after 31 March 1998, we believe that the conclusions of the evaluation can be used, as appropriate, for developing other similar programs.

## Human Resources Development Canada — Support for Training — 1995, Chapter 22

Assistant Auditor General: David Rattray Responsible Auditor: Louis Lalonde

### **Background**

35.225 In our 1995 chapter, we acknowledged that major changes in the approach of Human Resources Development Canada (HRDC) to training would likely occur. On 30 May 1996, the Minister of HRDC sent a proposal to the provinces and territories concerning the transfer of responsibility for the design and delivery of active employment measures funded through the Employment Insurance Account. Since then, new Labour Market Development Agreements have been put in place between the Government of Canada and eight provincial governments. The Agreements provide either for decentralization of active labour market measures to provinces (four Agreements) or for co-management (four Agreements). The remaining Agreements are currently under negotiation.

35.226 The objective of the 1995 chapter on support for training was to provide Parliament with reasonable assurance that the Department had established satisfactory procedures to measure and report the effectiveness of its training programs, where procedures could appropriately and reasonably be implemented. We focussed on the training measures found mainly under two employment programs administered by the Department: Employability and Labour Market Adjustment. We also reviewed labour market information activities.

**35.227** The chapter expressed some concerns regarding the limited information on current demand/supply

conditions in the labour market and on occupational shortages/skills gaps. It also identified shortcomings in the collection of data on training outcomes and in the resource allocation models for training support. In the area of program evaluation, we noted that the majority of evaluations examined were of acceptable quality within their scope. However, we recommended that more emphasis be put on measuring the effects of the training programs in helping to meet the skill needs of the economy, on surplus occupations and on worker mobility. We also highlighted the importance of measuring interprogram effects. Finally, we stressed the need to ensure that departmental evaluations of developmental initiatives address the full range of key evaluation issues and use the most reliable measurement methods possible.

### **Conclusion**

35.228 The new Labour Market Development Agreements have fundamentally changed the way the Department will manage and deliver Employment Insurance-funded active labour market programs in the future. Because of the long-term implications of many of the changes that are now taking place and because several of the agreements are not yet implemented, it will be a while before we can assess their impact and determine the extent to which our recommendations have been addressed. This is particularly true of program evaluations that will be conducted with provinces and territories in the future. We also recommended a model

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that would incorporate results feedback as a factor in determining budget allocations for training. In the context of the new Agreements, the Department decided not to proceed unilaterally without the support of the provinces and territories and to retain, for the time being, the resource allocation model covering the Employment Insurance Part II base fund. The Department is pursuing discussions with provinces and territories regarding a new resource allocation model.

35.229 We have concluded that the Department has made substantial progress in many of the areas that we audited in 1995. For instance, in the area of results measurement, it has implemented new systems that will generate more information on the performance and outcomes of active labour market programs. The Department has also taken significant steps to improve labour market information and is now collecting and publishing information on current labour market conditions. Finally, the Department has indicated that it would undertake an assessment of projections of labour market demand and supplies and that it would make these measurements on a regular basis.

### **Observations**

#### Labour market information

**35.230** The development of information systems on current and future labour market conditions for various occupational groups and regions is important in various situations; these include career counselling, educational planning, and the development of active labour market programs.

**35.231** Under the new arrangements, the federal government retains overall responsibility for the development of labour market information, although some

provinces have now assumed some responsibilities in this area. Until all the Agreements are finalized and implemented, how these responsibilities will be shared will remain unclear. However, HRDC will likely remain a significant producer and provider of labour market information. For instance, it is committed to publishing, on a more frequent basis, *Job Futures*, a detailed compendium of information on economic conditions that face newcomers to various occupational groups. This product is one of the significant outputs of the Canadian Occupational Projection System (COPS).

**35.232** In 1995, we noted the lack of comprehensive ongoing information on current occupational demand and supply conditions in the Canadian labour market, especially in terms of prevailing trends in skill shortages. Since 1995, the Department has revised the COPS methodological framework, in order to make it capable of providing labour market information on prospective future occupational imbalances between demand and supply. Together with this important first step, another positive development in this area is the production by the Department of information on current labour conditions. HRDC publishes this information in Job Futures in the form of qualitative ratings.

35.233 In our 1995 audit, we identified the need for the Department to conduct an analysis of causal factors related to skill shortages. The Department still does not produce such analysis. We also noted that the Department intends to establish a link between the experience of those who have recently left school and the current occupational labour market situation for the occupations in which graduates generally find jobs. We therefore encourage the Department to do the same for graduates of federally sponsored active

We have concluded that the Department has made substantial progress in many of the areas that we audited in 1995 labour market programs in order to help determine the effectiveness of such programs.

35.234 Finally, in 1995, we also concluded that COPS forecasts should be compared with what actually occurred and an analysis of the variances between the two should be undertaken. The purpose in this instance was to provide a tracking of the reliability of COPS, with a view to improving its usefulness and more clearly identifying labour market adjustment processes. The Department has stated its intention to proceed with an assessment of its forecasting record sometime past the midpoint of its first forecasting period (using 1995-98 data) and to implement these performance procedures on a regular basis thereafter.

35.235 Although there has been encouraging progress, we are concerned about the limitations of current information on the above-noted occupational imbalances in the economy. Our 1995 audit stated that a program evaluation undertaken by the Department in 1991 estimated, from an employer-based survey, that during the 1988 to 1990 period there were 300,000 hard-to-fill vacancies annually. We also noted in our 1995 audit that the lack of causal analysis in this area generates a risk that the federally sponsored training activities may not adequately respond to the economy's skill needs; as a result, the effectiveness of such active labour market programs in improving the employability of workers and lowering unemployment levels may be reduced.

#### Results measurement

**35.236** In our 1995 audit, we observed that ongoing feedback on cost effectiveness was lacking, that measures for monitoring operational results were

not fully implemented and that data reliability problems had been recognized.

35.237 The Department has taken some steps to address our concerns and has developed information systems that will collect data with the intention of facilitating client documentation, increasing the capacity to collect and report data on employment results, increasing efficiency and improving the reliability of information. For this purpose, the Department has developed several projects.

35.238 One project that has been implemented is Contact IV, a case management service delivery microcomputer system that is operational in approximately 860 third-party agencies providing employment services to HRDC clients. It facilitates documentation of client information and employment data for accountability and reporting purposes. A similar system, called Window Ness (NESS-GUI), has been developed for internal and provincial staff clients. The Department is also in the process of developing the Human Resources Investment (HRI) Client Data Set, which will provide national headquarters, regions and Human Resources Centres of Canada with consistent management information on clients who participated in various HRI activities. The integration with financial systems is presently under development. Once completed, it will allow the monitoring of unit costs per trainee.

### National allocation of program resources

35.239 We observed in 1995 that the national resource allocation models did not take account of results feedback. We recommended that such information be used as a factor to allocate resources. The federal proposal to provinces and territories for a new partnership in the labour market, released 30 May 1996,

stated that the allocation of funding would be equitable, transparent and based on a standardized set of objective labour market variables. HRDC subsequently decided that it would work in concert with the provinces and territories to develop a new mutually agreed-on formula for the interprovincial allocation of the **Employment Insurance Base Funding** rather than proceed in a unilateral fashion. For the time being, the allocation of Employment Insurance funds continues to be based on the existing formula that has been in place over the past several years and about which we identified a number of concerns in 1995.

**35.240** The Department is pursuing discussions with provinces and territories in this regard. Most of the Labour Market Development Agreements reference the possibility of a multilateral process for the review of the Employment Insurance resource allocation formula. Under the federal-provincial/territorial Forum of Labour Market Ministers (FLMM), jurisdictions have agreed to place the review of the Employment Insurance formula on the Forum's 1997-98 workplan. HRDC is the federal co-chair for the multilateral review process, while the FLMM has designated Ontario as provincial co-chair. The Department indicated that parties will be working together starting in fall 1997 to determine an appropriate process, options and timetable for implementation.

#### **Program evaluation**

**35.241** In 1995, we noted that the majority of the evaluations we examined

were based on analytical frameworks that were reasonable and appropriate; however, we recommended that the Department intensify its efforts and obtain regular feedback on the effectiveness of training activities. More specifically, we highlighted the need to measure and report the effects of training programs in helping meet the skill needs of the economy, and the effects of its support of training in surplus occupations. We also emphasized the need to examine skill levels of trainees before and after training and the effects of training on worker mobility in high unemployment regions. Finally, we identified a need to analyze and report on the interprogram effects of training and other programs.

35.242 Under the new Labour Market Development Agreements, HRDC and its provincial partners have agreed to conduct evaluations of program effectiveness based on the Agreements. The Agreements outline the obligation to develop evaluation frameworks that will guide the development of evaluation processes adhering to recognized evaluation practices. The Department has already developed guidelines outlining the core federal issues for the formative and summative evaluations and shared these with the provinces to initiate a collaborative evaluation process. These guidelines address the relevance, design, delivery, success and cost-effectiveness of the programs and services provided under the Agreements.

## Indian and Northern Affairs Canada — On-Reserve Capital Facilities and Maintenance — 1995, Chapter 23

Assistant Auditor General: Don Young Responsible Auditor: Grant Wilson

### **Background**

35.243 In November 1995, we reported observations and recommendations on capital facilities and maintenance funded by Indian and Northern Affairs Canada for Indian reserves. The facilities included water treatment and delivery systems, schools, roads and electrification. We recommended that improvements be made in several areas, including the way the activities were planned, funded and delivered.

35.244 Capital facilities and maintenance continue to be a stated priority of the Department in its efforts to improve living conditions on reserves across Canada. The applicable 1997–98 budget is \$806 million.

**35.245** The objectives of our 1997 follow-up were to determine the status of the 1995 recommendations, to identify emerging improvements, and to note any significant other matters that came to our attention.

35.246 Accordingly, we reviewed and tested the May 1997 status report provided by the Department on its progress in implementing recommendations. We considered all the reported action and focussed on selected aspects of project planning, implementation and evaluation in a major region of the Department. These aspects offer good opportunities to achieve better value for money while improving living conditions on reserves. We also inquired into current maintenance practices.

35.247 The follow-up included a review of 13 capital facilities projects having a cumulative value of approximately \$43 million. The region classified these as "major capital" projects.

### Conclusion

35.248 Most of the Department's efforts since 1995 have focussed on internal studies and reviews to help identify how improvements can be achieved. However, our review of selected capital facilities projects and related matters disclosed no significant improvements from key findings in 1995.

**35.249** Furthermore, additional concerns were noted in the region about the lack of agreement between the Department and First Nations on whether bid tendering should be used to select construction contractors.

35.250 We encourage the Department to implement the applicable recommendations fully and expeditiously and to resolve the issue of bid tendering. This should help the Department obtain assurance that good value is achieved for the funds provided and that improvements in living conditions on reserves are realized.

### **Observations**

#### **Results of project reviews**

**35.251** The purpose of reviewing 13 major capital projects was to identify any emerging improvements (or deterioration) in project planning, implementation and evaluation since the 1995 audit.

35.252 Overall, the audit sample disclosed no significant change from the

findings reported in 1995. For example, improvements are still needed in such areas as project risk assessments, monitoring, evidence of project completion and evaluation of project results.

35.253 A case example of additional issues is reported separately in Chapter 36Other Audit Observations.

#### Maintenance problems remain

**35.254** In 1995 we reported that the Department did not have the necessary assurance that maintenance funds were being used for the intended purpose and that maintenance of capital assets was performed appropriately. We also reported that the risks of inadequate maintenance are significant.

35.255 Up to an estimated \$270 million, or one third of the annual capital facilities and maintenance budget, is allocated to maintenance. Proper maintenance is needed to obtain appropriate levels of service from the asset and to avoid premature and costly recapitalization. We therefore expected timely action from the Department to address the 1995 audit concerns.

**35.256** An early 1997 internal assessment of operations and maintenance on reserves by a regional office of the Department raised several concerns, including:

- the lack of training and expertise in some First Nations to maintain assets;
- frequent turnover of maintenance personnel;
- the lack of incentive for First Nations to properly maintain assets; and
- the lack of a requirement for maintenance plans under certain funding arrangements with First Nations.

35.257 Under devolution, the Department continues to rely on First Nations community plans for any identified maintenance requirements. While the appropriate use of these plans can be beneficial, this approach alone may not be sufficient in every case because of the diversity of about 600 First Nations.

35.258 In June 1997, the Department issued draft compliance guidelines for the operation and maintenance (O & M) of capital assets on reserves. The purpose of the guidelines is to help ensure that O & M funds are used for the intended purpose, that the condition of the facilities is assessed annually and actioned where required, and that advice and assistance on maintenance are provided to First Nations. Full implementation of the guidelines is targeted for fiscal year 1998–99. In our view, the Department has not acted quickly enough to address this important issue.

#### Departmental action to May 1997

35.259 The Department reported that it had partially implemented all of the 1995 audit recommendations. Through its analysis of each recommendation and ongoing reviews of current policies, practices and evolving issues, the Department expects that most of the work remaining for full implementation will be completed by March 1998.

**35.260** According to the Department, various efforts to address the audit concerns and management needs are in progress or have been completed, including the following:

- An internal audit was conducted to assist managers in implementing improvements.
- Training programs were developed and expanded for First Nations water and sewer operators.

- A national workshop for departmental officials was held to discuss several capital management issues.
- Service standard levels are being revised.
- Operational targets are being updated.
- A study is under way to revise the Department's Cost Reference Manual to ensure comparability between on-reserve and other communities.
- Draft compliance guidelines have been issued to regions to address operating and maintenance issues.
- 35.261 Some documentation supporting these initiatives, such as draft compliance guidelines for the operation and maintenance of on-reserve capital assets, was issued toward the end of our follow-up audit. A proposed paper on funding allocations and the proposed Real Property Service Report on the Capital Asset Inventory System were still under development when we completed the follow-up and were not available for our review.

#### Bid tendering issues need resolution

- 35.262 During the follow-up, the issue of bid tendering for capital construction projects came to our attention. The issue includes the difficult challenge to the Department and First Nations of balancing lowest procurement costs, acceptable performance and socio-economic benefits to First Nations.
- 35.263 The devolution of program delivery to First Nations has been increasing for many years. In construction of capital facilities, First Nations generally select the contractors to be used. The current policy of the Department requires that First Nations use public tenders where the estimated construction costs of a project exceed \$500,000.

However, this approach is not supported by a First Nations technical group that believes that value for money, including spinoff benefits to the community, can be achieved through means other than public tendering.

- 35.264 We are concerned that unresolved tendering issues can lead to unnecessary increased costs in the delivery of capital projects. A case illustration of tendering issues is reported separately in Chapter 36 Other Audit Observations.
- **35.265** The Department has indicated that general principles to guide a First Nations tendering policy will be issued by March 1998.

Department's response: Following the release of the November 1995 audit on the On-Reserve Capital Facilities and Maintenance Program, Indian and Northern Affairs Canada developed an action plan that resulted in progress on each area of the recommendations made by the Auditor General. There are numerous initiatives currently under way, most of which will be completed by 31 March 1998. The Department will continue to work expeditiously toward the effective implementation of the applicable recommendations.

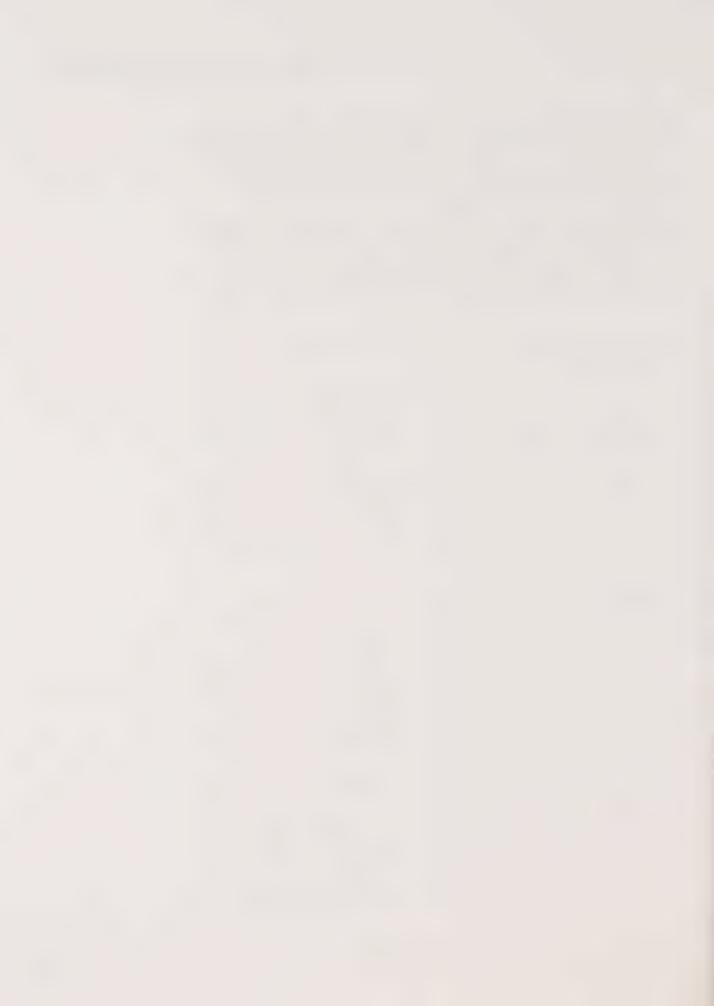
In particular, the Department has articulated its strategy for ensuring that on-reserve assets are properly operated and maintained through the issuance of an operations and maintenance compliance regime. The regional staff will work with First Nations to ensure full implementation by 31 March 1998. The Department believes that the time required to develop and implement this regime was appropriate due to the need to undertake regional consultation and collect the necessary data. In addition, the Department is working with First Nations in order to strengthen accountability to both First Nations communities and to Parliament. To achieve this, each First Nation and Tribal Council funded by the

Department is required to complete an assessment of its accountability and management system by 31 March 1998.

The Department recognizes the need to work with First Nations to implement the policy requirement for First Nations to use a tendering process for capital projects over \$500,000, excluding housing. In implementing this policy, the Department is faced with the challenge of achieving a balance between the concepts of achieving

best value for federal funds and increased socio-economic benefits for First Nations. The Department is working on a paper to define general principles for guiding First Nations tendering policies.

Important progress has been made toward improving living conditions on-reserve and the Department is well positioned to continue this progress while at the same time ensuring value for money.



# Chapter 36

**Other Audit Observations** 

The work that led to other audit observations was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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# **Other Audit Observations**

### **Main Points**

- **36.1** The *Auditor General Act* requires the Auditor General to include in his Reports matters of significance that, in his opinion, should be brought to the attention of the House of Commons.
- 36.2 The "Other Audit Observations" chapter fulfils a special role in the Reports. Other chapters normally describe the findings of the comprehensive audits we perform in particular departments; or they report on audits and studies of issues that relate to operations of the government as a whole. This chapter reports on specific matters that have come to our attention during our financial and compliance audits of the Public Accounts of Canada, Crown corporations and other entities, or during our value-for-money audits.
- 36.3 The chapter normally contains observations concerning departmental expenditures and/or revenues. The issues addressed generally involve failure to comply with authorities, and the expenditure of money without due regard to economy.
- **36.4** Observations reported this year cover the following:
  - information to Parliament on the use of "special measures" falls short of legislative requirements and Parliament's needs:
  - an initiative to provide spare parts failed to maximize its potential cost-saving benefits;
  - escalating costs of a water supply project were not adequately justified;
  - lack of compliance with a funding arrangement resulted in questionable costs;
  - an \$801 million payment raises concerns over accountability requirements;
  - the design and construction of a facility illustrates a "build [up] to budget" approach that does not encourage cost savings; and
  - departmental standards and practices were not followed in awarding a duty free shop licence.
- 36.5 Although the individual audit observations report matters of significance, they should not be used as a basis for drawing conclusions about matters we did not examine.



## Introduction

- 36.6 This chapter contains matters of significance that are not included elsewhere in the Report and that we believe should be drawn to the attention of the House of Commons. The matters reported were noted during our financial and compliance audits of the Accounts of Canada, Crown corporations and other entities, or during our value-for-money audits.
- **36.7** Section 7(2) of the *Auditor General Act* requires the Auditor General to call to the attention of the House of Commons any significant cases where he has observed that:
- accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;
- essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property; to secure an effective check on the assessment, collection and proper allocation of the revenue; and to ensure that expenditures have been made only as authorized;
- money has been expended other than for purposes for which it was appropriated by Parliament;
- money has been expended without due regard to economy or efficiency;

- satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented; or
- money has been expended without due regard to the environmental effects of those expenditures in the context of sustainable development.
- 36.8 Each of the matters of significance reported in this chapter was examined in accordance with generally accepted auditing standards; accordingly, our examinations included such tests and other procedures as we considered necessary in the circumstances. The matters reported should not be used as a basis for drawing conclusions about matters not examined. The instances that we have observed are described in this chapter under the appropriate department headings.
- 36.9 Consistent with Office policy on the follow-up of matters in our Reports, other audit observations included in this chapter are normally followed up two years after initial reporting. Three observations were included in our 1995 Report. In our follow-up of these observations, we found that in one case corrective action had been taken to address the matter. In another case, follow-up was not required since we did not consider the matter to be an outstanding issue. One observation remains outstanding because it involves matters that we are continuing to monitor, and any lack of corrective action will be reported as deemed appropriate.

This chapter contains a number of observations on matters of significance not included elsewhere in the Report.

# **Agriculture and Agri-Food Canada**

Information to Parliament on the use of "special measures" falls short of legislative requirements and Parliament's needs

Assistant Auditor General: Don Young Responsible Auditor: Neil Maxwell

Agriculture and Agri-Food Canada has used a "special measures" section of the Farm Income Protection Act (FIPA) to authorize a new class of safety net programming called provincial "companion programs". About \$415 million has been committed to these programs to date. The Department has not been in compliance with section 12(7) of the FIPA, which requires that each use of these special measures be authorized by an order-in-council tabled in Parliament. Since August 1995, more than 30 different programs have been so authorized to deal with "exceptional circumstances", but none of the orders-in-council have been tabled. A substantial number of these orders were issued more than one year ago.

To provide a reasonable basis for parliamentary oversight and control, the Department should provide additional information about the objectives, costs and results of these programs, in conjunction with tabling the orders-in-council required under section 12(7) or by other means.

## **Background**

**36.10** The Farm Income Protection Act (FIPA) was enacted in April 1991. The Act provides for the creation of "safety net" programs by authorizing "agreements between the Government of Canada and the provinces to provide for protection for the income of producers of agricultural products and to enable the Government of Canada to take additional measures for that purpose."

**36.11** Section 12 of the *Farm Income Protection Act* is titled "Special Measures", and subsection (1) provides:

Where the Minister is of the opinion that exceptional circumstances [emphasis added] exist that require that action be taken outside the scope of a program established under an agreement, the Minister may implement such procedures or other special measures as the Minister considers necessary to determine the appropriate action to be taken to remedy those circumstances ...

36.12 This section of the *FIPA* gives the Minister discretion to determine whether "exceptional circumstances" exist and to identify the specific actions he or she considers necessary to deal with them. These actions are given legal authority through the issuance of orders by the Governor in Council under section 12(5) of the Act.

36.13 Because actions taken under section 12 are outside the scope of established safety net programs, Parliament included a requirement under section 12(7) to ensure that it would be kept informed of any use of these "special measures". Subsection (7) states that every order taken under section 12(5) shall, "as soon as possible" [emphasis added] after it is authorized, "be laid before each House of Parliament."

#### Issues

**36.14** At 1 October 1997, more than 30 provincial "companion programs" had been authorized by the Governor in Council pursuant to section 12(5) of the

At 1 October 1997, more than 30 "companion programs" had been authorized by order-in-council. However, none had been laid before Parliament, as required by legislation.

- FIPA. Companion programs are province-specific agreements designed to enhance existing national safety net programs like the Net Income Stabilization Account and Crop Insurance. They are one element of the safety net framework negotiated with the provinces, and are intended to address region-specific needs. About \$415 million has been committed to these programs to date.
- 36.15 However, at 1 October 1997, none of the orders-in-council issued under 12(5) to authorize these programs had been laid before either House of Parliament, as required by 12(7). This control, although "after-the-fact", is an important tool for parliamentary oversight. In particular, it identifies for parliamentarians, in a timely fashion, any use of the "special measures" provisions of the *FIPA*.
- 36.16 In its Estimates for both 1996–97 and 1997-98 and in its 1996 Performance Report, the Department has indicated that a new framework for safety net programming is now in place, and that companion programs are a major component of that framework. The 1996-97 Estimates included a description of broad categories of companion programs. However, Parliament has not received any detailed information about objectives, costs and results of the companion programs — information that is essential to any meaningful oversight role.
- **36.17** There are several factors associated with these companion programs that highlight the need for additional reporting to Parliament:
- the existence of "exceptional circumstances" and the extensive use of special measures under 12(5), which by themselves warrant being brought to Parliament's attention:
- the significant financial commitment involved;

- the "pilot-like" nature of many of these companion programs, which address areas outside the scope of traditional safety net programs (e.g. adaptation, innovation, research and development); and
- the impact these companion programs are expected to have on the design of the next generation of safety net programs coming on-stream in the 1999–2000 fiscal year, for which the consultation process is just beginning. Some form of reporting on the preliminary results achieved from the companion programs would obviously be pertinent to those consultations.
- 36.18 We think Parliament needs a concise, complete listing that provides summary information about program objectives, costs, expected results, how results will be measured and completion dates. The fact that, apart from 12(7), there are no specific legislative reporting requirements for the "special measures" gives the Department considerable flexibility to choose the vehicle or vehicles it feels are most appropriate for providing the necessary information. These could include the Department's Estimates Part III, its Performance Reports or presentations to the Standing Committee on Agriculture and Agri-Food, as well as providing this information in conjunction with the tabling of the orders-in-council under 12(7). The nature, extent and timing of the information to be provided are all important considerations in assisting Parliament in its oversight

#### Conclusion

**36.19** To date, Parliament has not been provided with an adequate information base for oversight and control of the series of companion programs recently authorized under the "special measures" provisions of the *FIPA*. To provide the necessary information, the Department should table before Parliament all orders-in-council issued under section

Parliament has not received any detailed information about objectives, costs and results of the companion programs.

12(5) of the FIPA, as required by section 12(7). In addition, it should provide Parliament with timely and relevant information about the objectives, costs and expected results of the companion programs and, in due course, their actual results, in conjunction with the tabling of orders-in-council under 12(7) or by other means.

Department's response: Agriculture and Agri-Food Canada (AAFC) shares the Auditor General's commitment to improving the quality and timeliness of information provided to Parliament. That is why AAFC was among the 16 departments and agencies that volunteered to participate in the Improved Reporting to Parliament Project. This pilot project resulted in the recent tabling of fall Performance Reports.

AAFC acknowledges its obligation under section 12(7) of the Farm Income Protection Act (FIPA) to table all orders-in-council pursuant to section 12(5). The Department's preference would have been to lay before Parliament a complete package pertaining to all federal-provincial companion programs since these have been developed as a set. There are still some agreements under negotiation. Nonetheless, in light of the concerns of the Office of the Auditor General (OAG), the Department has initiated a process to table existing orders-in-council as soon as possible.

The Department looks forward to continuing to work co-operatively with the OAG and other stakeholders to improve parliamentary reporting practices.

## **Fisheries and Oceans / Coast Guard**

Assistant Auditor General: Shahid Minto Responsible Auditor: Reno Cyr

An initiative to provide spare parts for the Louis S. St. Laurent icebreaker has failed to maximize its potential cost-saving benefits

In 1996, we found significant deficiencies in the government's materiel management practices, including buying and stocking inventories of items that were readily available commercially. Our current audit illustrates the challenges posed when adopting new management practices. Since December 1994, the Coast Guard has taken a new approach to acquiring spare parts for the Louis S. St. Laurent icebreaker, and has now paid over \$300,000 to a private sector supplier to stock an inventory of engine spare parts. The spirit and intent of this initiative are consistent with the objectives of better service at less cost; however, it appears that neither of these objectives is being maximized. In 1994, the contract was entered into without adequate analysis. In 1996, a new contract did not reflect changes in requirements. In our opinion, to obtain better value for money for the Crown, the Coast Guard needs to re-examine the provisions of this agreement in light of past performance and the current operational requirements of the vessel.

## **Background**

36.20 The Fisheries and Oceans/Coast Guard Icebreaker Louis S. St. Laurent (the Louis), Canada's largest and most powerful icebreaker, was built in 1969. In 1988, the Canadian Coast Guard delivered the Louis to a shipyard for a midlife modernization project that included a 20-year life extension. In 1993, the ship re-entered service following the problematic modernization project, in which the total cost escalated from an effective project approval of \$75.8 million in 1987 to about \$159 million. We reported on the midlife modernization issues in 1990.

36.21 In our November 1996 Report chapter, Materiel Management in the Federal Government, we noted significant deficiencies in the government's materiel management practices. Departments were holding excessive quantities of items that had to be stocked, as well as items that were readily available commercially and did not have to be stocked. We became

aware of this Coast Guard initiative during the 1996 audit.

36.22 The Coast Guard took a new approach to acquiring genuine replacement spare parts and technical support for the German-manufactured diesel engine propulsion units of the Louis. Rather than the traditional approach of purchasing a complete set of spare parts and incurring holding costs to store them itself, the Department entered into a life-cycle support agreement with the supplier of the engines to provide these services for a basic monthly holding fee plus the cost of any parts used. The intended benefits to the Coast Guard of this arrangement included no up-front capital investment in spare parts, no direct holding costs, no risk of obsolescence, and delivery within 24 to 48 hours of genuine replacement parts when needed, resulting in minimum downtime of the vessel on operational taskings.

**36.23** In our opinion, before entering into such an agreement, the participants must have a good knowledge of the costs and clearly articulated performance

We noted an absence of any risk analysis by the Coast Guard to establish the need to hold various types of spare parts.

expectations. Once a contract is signed, there needs to be ongoing monitoring of performance and refinement of requirements based on the experience gained. In the case of this initiative, we found neither.

#### Issues

36.24 Lack of adequate analysis prior to entering into a contract. The Louis was expected to be heavily tasked after completion of the costly modernization project; quick response times to mechanical breakdowns would be necessary to maintain a high level of operational readiness.

36.25 In December 1994, the Coast Guard entered into an agreement under which it would pay the supplier approximately \$5,600 per month to hold specific items in storage at the company's Canadian warehouse, for the exclusive use of the Louis. Neither the Coast Guard nor Public Works and Government Services Canada, who negotiated the agreement, could clarify for us the basis and justification of the supplier's \$5,600 monthly fee for its services. The supplier

did provide a rationale for pricing based upon a percentage of the inventory held, but it was found to be weak and lacking in detail. We also noted the absence of any risk analysis by the Coast Guard to establish the need to hold various types of spare parts. In our opinion, those parts that could be purchased through the supplier's normal commercial channels would not need to be held and incur holding fees.

36.26 The supplier's literature advertises a worldwide sales and service organization that ensures around-the-clock customer satisfaction through well-equipped spares depots in the main markets. In addition, the supplier has a central spares depot in Germany with approximately 96 percent of all engine parts in stock, and claims that more than 80 percent of orders received in the morning are filled the same day. The scope of our audit did not include verifying these claims. We have been informed by the supplier that it does not maintain a dedicated stock, such as that for the Coast Guard, for its other commercial clients.

The Louis S. St. Laurent is Canada's largest and most powerful icebreaker (see paragraph 36.20)



36.27 We support the Coast Guard's initiative in trying a new approach to providing spare parts. However, we would have expected that before entering into such a contractual arrangement, the Coast Guard, with the support of Public Works and Government Services Canada, would have conducted a thorough analysis to determine whether the arrangement would be beneficial to the Crown. This would include estimating the costs and benefits of all available options. We found no evidence of such an analysis.

36.28 New contract does not reflect changes in requirements. In January 1996, a new contract was signed that extended the agreement to 30 May 1999. The contract increased both the total value of the spare parts held by the supplier (from about \$570,000 to about \$920,000) and, commensurately, the monthly holding fee (from about \$5,600 to about \$10,300). We found inadequate information to support the increase in the monthly fee and no rationale for the increase in inventory. Prior to signing the new contract, an internal report by a Public Works and Government Services Canada cost analyst had raised similar concerns about the justification of the monthly fee.

36.29 The significant increase in the spare parts inventory came at a time when the Louis was being underutilized. Coast Guard records indicate that since its redeployment following the modernization project, the Louis has been tasked less than 50 percent of its available time. On occasion, there have been lengthy periods of time between taskings. Coast Guard officials have stated that the engines' performance has been better than specifications and that the contractor's service record has been excellent.

#### Conclusion

**36.30** We found no program of monitoring the usage rates and operational taskings as a basis for refining the appropriate levels of inventory of spares

held. In our opinion, since signing the contract in 1994, the Coast Guard has not performed sufficient monitoring and analysis to manage and refine the level of spare parts held in order to obtain best value for the Crown. We would expect to see an analysis identifying the minimum inventory of spare parts needed to be held for the Louis, taking into account the worldwide availability of parts from the supplier.

36.31 Subsequent events. In the spring of 1997, during the conduct of our audit fieldwork, we expressed our concerns to the Coast Guard about the size of the inventory and the monthly fees paid. The opportunity to revise the contract on its renewal date in June 1997 was missed. In September 1997, the Coast Guard informed us that the contractor's inventory had been reviewed and a reduction of \$156,000 had been identified for the period June 1997 to May 1998. The Coast Guard acknowledges that this information was not forwarded to the contractor by the June renewal date, but it believes that an interim adjustment will be negotiated. We believe that this has resulted in additional needless expenditures and poor value for money for the Crown.

Department's response: As at 4 November 1997, inventory levels had been reduced by \$156,000 as identified by the Auditor General. The Department will continue to reduce holdings, with the ultimate goal being "just-in-time" delivery of spare parts. These reductions will be based upon analysis of data from upgraded machinery and inventory monitoring programs now in place, in conjunction with the demonstrated delivery track record of the propulsion system contractor and the contract further adjusted accordingly.

We found no program of monitoring the usage rates and operational taskings as a basis for refining the appropriate levels of inventory of spares held.

#### Other Audit Observations

Given the remote area of deployment, the Department followed a prudent course of action in treating the serviceability claims of the manufacturers with cautious optimism. The soundness of this approach has been confirmed by the stellar performance of the vessel to date, meeting

every challenging demand and setting many new records in Arctic navigation.

This objective is an integral part of the maintenance management philosophy of the Department to maintain a high level of performance at minimum cost.

## **Indian and Northern Affairs Canada**

Assistant Auditor General: Don Young Responsible Auditor: Grant Wilson

Escalating costs of on-reserve water supply project not adequately justified

A water supply development project, funded by Indian and Northern Affairs
Canada, was undertaken on a reserve because of contamination in a river used as a
source of treated drinking water. Estimated costs of the project, currently in
progress, increased significantly in less than two years. Preliminary project
approval by Indian and Northern Affairs Canada in September 1995 was \$1 million.
By April 1997, the revised planned cost had climbed to \$2.3 million, more than
twice the original estimate. Furthermore, the Department was aware that according
to an engineering consultant engaged by the First Nation, the contamination could
have been treated by improving the existing water treatment plant at an estimated
cost of \$26,000.

## **Background**

**36.32** Adequate drinking water is an important priority for Indian reserves across Canada and for Indian and Northern Affairs Canada in its funding of on-reserve capital projects. It is especially important that adequate water be made available in a cost-effective way, because resources are limited and the needs are considerable.

**36.33** During the follow-up of our November 1995 Chapter, Indian and Northern Affairs Canada: On-Reserve Capital Facilities and Maintenance (see Chapter 35 of this Report), we observed the following case.

36.34 In March 1993, a First Nation community of about 400 reported its concerns to the Department regarding contamination in the community's drinking water sourced from a river. In the same month, a study by an engineering consultant engaged by the First Nation identified deficiencies in the existing on-reserve water treatment plant and its operation. The estimated cost to improve the plant and the quality of water was \$26,000 for an expected population of 700 by year 2000. Other considerations for

longer-range needs and fire control were identified but not costed.

In May 1993, the Department 36.35 noted that tests of treated water at the treatment plant showed a higher concentration of aluminum than that found in tests of river water. According to the Department's Technical Services, the problem appeared to stem from the water treatment plant. In September 1993, the Department recommended that the First Nation improve the treatment plant. In May 1994, the First Nation reported to the Department that the funds provided to it by the Department to repair the plant and to cover an interim supply of bottled water were inadequate.

**36.36** According to the Department, the First Nation had lost confidence in the river as a source of potable water and insisted on establishing a new source of supply. In September 1995, the Department gave preliminary approval to the First Nation's proposal for a \$1 million project to develop a new source of water on the reserve.

#### Issues

**36.37** Our review of this project disclosed that the approach and scope of the work changed significantly over time.

It is especially important that adequate water be made available in a cost-effective way, because resources are limited and the needs are considerable.

The approach recommended in the March 1993 study to improve the treatment plant and its operations at a cost of \$26,000 would provide for continued use of the river as a source of drinking water. Although the Department indicated that it had provided \$30,000 to the First Nation to implement the study's recommendations, no evidence was available in the Department to show what improvements had been made with these funds.

- 36.38 At various times, up to preliminary approval in September 1995 and subsequently, several technical issues and options were discussed for establishing an alternative supply of drinking water. For example, in May 1995 another engineering consultant engaged by the First Nation proposed four options for developing a new source of raw water. However, none of the options included a cost analysis of continuing to use the river as a source.
- One of the options was selected at a proposed cost of \$1 million. This involved constructing three wells as a new source of supply, which were intended to service a community of 800 expected by 2025. However, this approach was abandoned, and under a proposal in November 1996 by yet another engineering consultant engaged by the First Nation, approval was given to construct five new wells in another location. This included the necessary water mains and related facilities for \$1.6 million. The estimated cost increased to \$2.3 million by April 1997, including the cost of treating other identified contamination associated with the new location. By this time, over \$1 million had been spent on or committed to this project.
- **36.40** We believe that significant issues were not adequately resolved before the decisions were made to proceed with and expand the project. These include the following:

- The Department failed to ensure that identified problems in the existing treatment plant were remedied and that funds provided to the First Nation for this purpose were used appropriately.
- The Department did not adequately take into account the contamination relating to the wells before committing to this approach.
- The Department accepted analyses of four options submitted by the First Nation, which excluded the river as a water source option. This was despite the Department's knowledge before approving the project that the river could be a viable source of water, properly treated in the existing plant, and that plant improvements could be achieved for only nominal cost.
- We could find no life-cycle cost analysis that compared the estimated \$2.3 million cost of the selected project, to service the estimated needs of a projected population of 800 by 2025, with a \$26,000 cost to improve the existing plant for a projected population of 700 by 2000. We would expect an analysis to have disclosed the assumed benefits and costs of the alternatives, including consideration of the river as a continued source of treatable water.

#### Conclusion

36.41 Accordingly, we concluded that there was inadequate justification for the cost escalation in this project. Given the considerable demand for improvements to on-reserve capital facilities, we believe that other worthy projects may have been adversely affected because of the cost escalation in this project.

Department's response: The First Nation had serious concerns regarding the contamination of their water supply. Those concerns were subsequently confirmed with Health Canada. The Department worked with the First Nation to ensure that the community had access to safe, reliable drinking water.

The Department carefully examined potential options to solve the water quality issue, including retrofitting the existing plant, but ultimately other alternative sources had to be examined. The options considered needed to address the concerns of the community carefully and provide them with an appropriate source of water.

Given the circumstances involved in this particular case, the Department feels that it took a reasonable approach in providing a safe, reliable source of drinking water in a cost-effective manner, taking into consideration the concerns of the community. The project is expected to be put into operation in November 1997.

## **Indian and Northern Affairs Canada**

Assistant Auditor General: Don Young Responsible Auditor: Grant Wilson

Lack of compliance with funding arrangement results in questionable costs and benefits

During the fiscal year 1996–97, Indian and Northern Affairs Canada approved an \$8.9 million on-reserve infrastructure project to be constructed by a First Nation. As of March 1997, the Department had allocated \$3.5 million toward the project. A condition in the project funding arrangement between the Department and the First Nation requires that the First Nation call for public tenders of all construction contracts.

Instead, according to the Department, the general contractor selected by the First Nation was awarded the contract on a negotiated fixed-price basis. Furthermore, a departmental project risk analysis determined that the lack of tendering and the selection of the chosen contractor resulted in estimated extra costs ranging from \$700,000 to about \$1 million. The analysis also estimated other risks at \$594,000, although this amount might have been applicable to any contractor selected. The Department indicated that the extra costs and risks were offset by socio-economic spinoff benefits to the community. However, the Department could not adequately demonstrate the basis for the offset.

## **Background**

36.42 During the follow-up of our audit reported in Chapter 23 of the November 1995 Report, Indian and Northern Affairs Canada: On-Reserve Capital Facilities and Maintenance, we noted unresolved issues regarding bid tendering (see Chapter 35 of this Report). The following case came to our attention.

36.43 A major capital construction project to provide water and sewer services on a reserve was approved by the Department for \$8.9 million during the fiscal year 1996–97. As of March 1997, the Department had allocated \$3.5 million to the First Nation for this project, which was still in progress at the time of our audit.

36.44 Under the funding arrangement between the Department and the First Nation, public tendering is required for all construction contracts to ensure prudence, probity, sound contract management, and

best value, which may include consideration of opportunities to secure socio-economic benefits for the community. Instead, public tendering was not used to select the general contractor, which was awarded the project by the First Nation for a negotiated fixed price of \$8.9 million.

#### Issues

36.45 According to the Department, the general contractor was an incorporated company formed just prior to the project and owned by the same First Nation that received approval and funding for the project. A departmental project risk analysis estimated that the extra cost to the project arising from the lack of tendering was about \$700,000. Additional potential costs attributable to the inexperience of the selected contractor and to related matters were estimated at \$358,000, bringing the estimated cost and risk premium to about \$1 million. Other

project risks were estimated at \$594,000, which, according to the Department, might have been applicable to any selected contractor. The Department indicated that all of these costs were included in the approved amount of \$8.9 million. The First Nation indicated that in its view, there were no extra costs and risks attributable to the selection of the contractor as described in the Department's analysis.

36.46 The Department stated that the extra costs and risks incurred in the fixed price award to the general contractor were offset by socio-economic spinoff benefits, deemed to be \$2.4 million. We believe that project spinoff benefits and the premium paid to achieve them should be supported by an appropriate analysis that determines, among other things, the value of benefits by type and their expected duration. Assumptions used for each benefit also need to be clearly stated, consistent with supporting rationale. However, during our review, the Department could provide no analysis to support the deemed benefits. The First Nation reported that community spinoff benefits were achieved and, although it did not quantify them, did not agree with the deemed value of \$2.4 million.

#### Conclusion

36.47 The Department failed to comply with the conditions of its funding arrangement. The tendering requirement was not enforced by the Department and tenders were not called for by the First Nation as required. In our opinion, non-compliance by the parties does not augur well for effective implementation of the arrangement. Furthermore, in the absence of a supporting analysis, the

justification for accepting the cost and risk premium of up to \$1 million by not tendering, and the deeming of benefits of \$2.4 million, were questionable.

Department's response: In this particular case, a reasonable final price for the project was obtained. The Department ensured local benefits for the First Nation through a flexible approach to the tendering process. This approach enabled the First Nation to participate in a joint venture on components of the project, which, in turn, supported capacity development at the local level.

The Department ensured that value for money was obtained by negotiating with the First Nation an upper limit for the project costs and requiring that the subcontracts (approximately 70 percent of the total project cost) were publicly tendered. The remaining 30 percent of the work was negotiated as local set asides using standard industry rates in the area to ensure that a fair and reasonable price was obtained. The final costs for the project are comparable with the cost estimated for a public tendered contract including a local preference allowance.

The Department has established a requirement for First Nations to use a tendering process for capital projects over \$500,000, excluding housing, and it recognizes the need to work with First Nations to implement this policy. As recognized by the Auditor General, the Department is faced with the challenge of achieving a balance between the concepts of achieving best value for federal funds and increased socio-economic benefits for First Nations. The Department is working on a paper to define general principles for guiding First Nations tendering policies.

We believe that project spinoff benefits and the premium paid to achieve them should be supported by an appropriate analysis.

# **Industry Canada**

Assistant Auditor General: Richard Flageole Responsible Auditor: Peter Simeoni

Concerns over accountability requirements for \$801 million payment

The government made a payment of \$801 million to the Canada Foundation for Innovation. The funding agreement does not obligate the Foundation to report on the results it achieves with this money. In our view, it is important that any future funding agreements with similar organizations provide for a full annual report on performance to Parliament.

## **Background**

36.48 Parliament established the Canada Foundation for Innovation through the *Budget Implementation Act, 1997* as an independent, not-for-profit corporation whose purpose is to make grants "to increase the capability of carrying on high-quality research in Canada." The Foundation is made up of 15 members, representing the research and business communities, and is managed by a separate board of directors. The Act authorized the Minister of Industry to pay up to \$800 million plus interest to the Foundation.

The Minister and the Foundation 36.49 reached a funding agreement in July 1997. Its purpose was to set out the terms and conditions under which the Foundation would administer and invest the payment from the government and would determine which projects to fund. The agreement requires the Foundation to endeavour to commit the \$801 million and any investment proceeds (an estimated \$100 million) to projects within five years. The Foundation will use the money to support the modernization, acquisition or development of research infrastructure such as equipment, software, buildings and other facilities by making grants of up to 50 percent of the total cost of eligible projects. The agreement also defines

eligible recipients, projects and costs as well as setting out submission requirements and factors the Foundation must consider in reviewing applications. The provisions are intended to help ensure that the Foundation funds projects that meet the agreement's objectives.

**36.50** In announcing the creation of the Foundation, the government stated:

The Foundation represents an entirely new approach by the government to supporting innovation and research. It will be an independent corporation, at arm's length from the government, and its members will be drawn from the research community and the private sector. They, not the government, will be responsible for spending decisions.

36.51 We examined the government's funding agreement with the Foundation to determine whether it provided for good accountability to Parliament for the \$801 million payment. In our view, good accountability begins with the government clearly describing its goals and planned actions and ends with a full accounting to Parliament for the results achieved. Reporting obligations need to be clearly set out and cover both financial and operational results when the government enters into "arm's length" arrangements or into partnerships to achieve these goals.

Reporting obligations need to be clearly set out and cover both financial and operational results when the government enters into "arm's length" arrangements or partnerships.

#### Issues

# No obligation to report on results achieved with \$801 million

The Act requires the Foundation to prepare an annual report of its activities, including audited financial statements, which the Minister of Industry tables in Parliament. We expected that the funding agreement would elaborate on this general requirement to provide for good accountability to Parliament for the \$801 million payment by obligating the Foundation to report not only on its activities but also on its performance more broadly — in other words, on the results it achieved with the grants it made. While we recognize that the Foundation is independent, the annual performance reports of the government's granting councils for science illustrate at least the kind of reporting that is possible. In particular, these annual reports are supposed to present results achieved by the councils through their granting activities. However, the funding agreement with the Foundation contains no such provision. While it appears that the Foundation will nonetheless make every effort to give a good annual account of its achievements toward its objectives, our concern is that the government did not obligate it to do so. In our view, any future funding agreements with similar organizations should unambiguously require that a full, annual accounting for performance be made to Parliament, and that this report be audited. This is particularly important as the government provides more goods and services through partnerships with organizations outside the traditional public service, and therefore outside established performance reporting systems.

**36.53** Although the funding agreement does not provide for it, program evaluation is an important part of performance measurement and reporting. There is, of course, nothing preventing the Foundation from having an evaluation

carried out and reporting the results to Parliament. In our view, future funding agreements such as this should have an evaluation requirement so that Parliament is informed of what was accomplished with the funding provided.

#### Conclusion

36.54 The government made a payment of \$801 million to the Canada Foundation for Innovation. The funding agreement does not obligate the Foundation to report on the results it achieves with this money. In our view, it is important that any future funding agreements with similar organizations provide for a full annual report on performance to Parliament.

Department's response: The funding agreement addresses the accountability issue by setting out appropriate terms and conditions on the use of the \$801 million by the Foundation. Specifically, the agreement sets out: four specific objectives that will guide the Foundation in all of its activities and decisions; extensive provisions with respect to the specific project costs that are eligible and excluded, for purposes of cost-sharing with the Foundation; a requirement that applicants must provide a research plan that contains specified information, as well as other information; mandatory criteria that all successful applicants must meet, as well as criteria to be used when assessing proposals; the requirement to establish a peer review system to assess research plans; and how in-kind contributions are to be treated. Taken together, these provisions will be critical in ensuring that those infrastructure projects funded by the Foundation will be of the highest quality, with the highest socio-economic potential.

The Foundation is working to develop a framework to evaluate the results of its grants for research infrastructure. Of course, one has to bear in mind that the research projects will take time to come to fruition and have an impact on the economy and society. The establishment of

Future funding
agreements such as
this should have an
evaluation requirement
so that Parliament is
informed of what was
accomplished with the
funding provided.

#### Other Audit Observations

the Foundation as an arm's length organization represents an original and unique approach to supporting innovation in Canada. A highly qualified Board of Directors with diverse expertise,

experience and perspective is being put in place that, we are confident, will meet the challenge of maximizing the benefits flowing from the Foundation and meet the innovation needs of Canada.

# **National Archives of Canada and Public Works and Government Services Canada**

Assistant Auditor General: Shahid Minto Responsible Auditor: Reno Cyr

The design and construction of the National Archives of Canada's Gatineau Preservation Centre could have been achieved in a less costly building. The facility illustrates a "build [up] to budget" approach that does not encourage cost savings

Design and construction of the Gatineau facility has been achieved at a higher unit cost than a similar-purpose U.S. facility. The design requirements imposed by the selected site, and the creation of this striking facility in response to the National Archives' objective to create a facility with the image of a leading archival centre having a national heritage and cultural element, have contributed to the higher cost.

During construction of the Gatineau Preservation Centre and subsequent to our 1994 audit, the elimination of \$10 million in unnecessary extras in the design, finish and landscaping was required to meet budget targets. The reduction was achieved without unduly compromising program requirements.

In our opinion, the storage, preservation and active conservation functions, which exclude any significant access to the facility by the public, could have been accommodated in a less expensive building. The fact that significant cuts were achieved but that additional cost-saving opportunities were not exercised illustrates the lack of cost-saving incentives under the government's "build [up] to budget" approach.

## **Background**

As part of a composite project to respond to the needs of the National Archives of Canada, including the need to arrest the deterioration of records in existing storage facilities, a new conservation and laboratory building was constructed in the city centre of Gatineau, Quebec, at a total project cost of \$107 million. The second part of the composite project was to renovate the West Memorial Building to create public research facilities and replace those currently provided in the National Library building, and to refurbish the National Archives headquarters. The second project was approved in May 1996 and is expected to be completed by 2002.

**36.56** • The new Gatineau facility provides for the consolidation of storage and laboratories from several facilities and allows for further consolidation and future growth of the archival records. The facility has been designed to provide a safe environment for the long-term storage and active preservation of the country's valuable collections.

36.57 In 1994 we examined the preliminary stages of construction of the new Gatineau facility and concluded, in part, that there was a lack of due regard to economy in the site selection and related design, finish and landscaping considerations for the facility.

**36.58** In 1995 we undertook a joint study with National Archives of Canada and Public Works and Government

Services Canada to compare the cost of the new Gatineau facility with a similar-purpose U.S. facility.

36.59 In 1996 we reported on the government's "build [up] to budget" philosophy in our audit of a large government-owned special purpose facility. Under this approach, certain aesthetic enhancements to the facility were included on the basis that the budget would not be exceeded. In its published response, the Treasury Board Secretariat acknowledged the need to place greater emphasis on cost savings within the overall approved budget.

36.60 The new Gatineau facility, now referred to as the National Archives of Canada Gatineau Preservation Centre, was made available for occupancy in December 1996, and was officially opened on 4 June 1997. The relocation of records into the new vaults of Phase I of the Gatineau facility is ongoing and expected to be completed by March 1998. A Phase II project is planned in Gatineau for some time in the future to provide for further consolidation and growth of the collections.

#### Issues

36.61 Gatineau facility is more expensive than a similar-purpose U.S. facility. At the time of reporting our 1994 audit, agreement could not be reached with National Archives of Canada and Public Works and Government Services Canada on the appropriate costs to include in comparing the Gatineau facility with the recently completed United States National Archives and Records Administration (NARA) II facility in College Park, Maryland. It was agreed that a joint study would be undertaken to confirm and explain the cost differences. The study findings, agreed to by the joint participants and reported to the deputy heads in October 1995, are summarized in this section.

36.62 The three major cost elements of both projects, representing approximately 80 percent of the total project costs, include construction (contracts and material), architectural and engineering services (A & ES) management, and professional services. Architectural and engineering services management includes design reviews, preparation and review of documents, commissioning, administration and auditing. Professional

U.S. National Archives and Records Administration Facility — an archival facility of conventional design opened in May 1994, incorporating a significant public access role (see paragraph 36.61)



services cover such things as architectural fees, special consultants and taxes.

36.63 The findings of the cost study, which support the preliminary conclusions of our 1994 audit, are summarized in Exhibit 36.1. Comparison of the individual project cost elements for the two facilities, on a unit-cost basis, shows a cost difference of 29 to 66 percent. The construction management activity, represented by combining the individual elements of A & ES and professional services, account for a 58 percent difference. In all cases, the percentage differences reflect the lower cost of the U.S. facility.

36.64 Due to the differences in size of the facilities, the comparison uses the industry standard approach of comparing costs per square metre of building gross area in arriving at the percent differences. Construction unit costs, based on industry standards for measuring gross area, were calculated after deleting some components from the NARA II facility to achieve a more accurate comparison of constructed features.

36.65 It should be noted, however, that the study also indicated that comparisons between unique special purpose buildings are difficult and will not give a definitive answer. The factors that limited the opportunity for comparison of the projects included funding mechanisms, design life cycles, building area and location, user programs, and contracting and

implementation policies. These limitations notwithstanding, the study identified several factors that contributed to the higher cost of the Gatineau facility, as follows:

- The method of funding. Because the funding for the NARA II facility was received as a lump sum, the project benefited from the ability to tender contracts when the timing in the construction industry was opportune.
- The management of tendering and contracting. NARA had final contracting authority and did not have to seek additional approvals for each contract. This authority shortened the tendering period and encouraged the use of more and smaller tender packages.
- Site selection. The design of the Gatineau facility was significantly influenced by its urban and highly visible site. The design of the NARA II facility was not influenced to this extent by its siting.
- Fees. Consultant fees and management and supervision fees were higher on the Gatineau project. There were extra layers of management, due in part to the number of parties involved and the division of their roles.
- Incentives for cost savings. There were incentives for NARA to achieve cost savings on its construction project, but no such incentives for National Archives on its project. Since NARA had complete

Comparison of cost elements with a similar purpose U.S. facility shows a cost difference of 29 to 66 percent, on a unit-cost basis.

Project Cost Element	Gatineau Facility (32,500 sq m)	NARA II Facility (170,900 sq m)	Unit Cost % Difference
	\$(000)	\$(000)	
Construction	72,639	270,125	29
A & ES Management	. 5,425	15,796	45
Professional Services	8,081	14,323	66
Total A & ES Management & Professional Services	13,506	30,119	58

Exhibit 36.1
Summary of Cost Comparisons

In granting preliminary project approval,
Treasury Board
ministers expressed
the view that design
and consequent costs
of the Gatineau facility
should place emphasis
on functional
requirements.

This project raises serious questions about whether further cost savings could have been achieved without compromising program requirements.

control of its construction budget and would have had to fund any shortfalls from its operating budget, there was pressure to control costs. As an added incentive, cost savings on construction could be and were used to purchase furniture and equipment and to upgrade some key systems. For the Gatineau facility, any cost savings from construction would not accrue to the client but rather to Public Works and Government Services Canada, the contracting agent.

"Build [up] to budget" 36.66 approach does not encourage cost savings. In 1994 we noted that funds were being spent on site and design considerations that exceeded the functional needs of the building. In granting preliminary project approval, Treasury Board ministers expressed the view that design and consequent costs of the Gatineau facility should place emphasis on functional requirements. We concluded that the siting of the facility and concerns with public visibility resulted in a design that emphasized factors other than the functional requirements. For example, the intent of the client's general design, as conveyed to the architect, emphasized that "the Gatineau Building will present the image of a leading archival centre, a National heritage and cultural element", despite the absence of plans for any significant access to the facility by the public and a mandate to stress functionality.

36.67 Since 1994, a review of the project budget and contract requirements was necessitated when the low bid for the major construction contract came in approximately \$10 million over budget. The review concluded that significant cost savings were possible without unduly compromising program requirements. Revisions were then made to the design and materials to meet the budget. We believe that this illustrates the need for a more rigorous and meaningful analysis of

project requirements before a budget is approved.

The government's project 36.68 approval and project management policies provide incentives not to exceed approved budgets, but there is little incentive to bring projects in under budget, even where significant excesses exist. In this project, the elimination of \$10 million of unnecessary extras, of which a significant portion represents the cost of stainless steel, would not have occurred had the low bid not exceeded the contract budget. However, notwithstanding the cuts already made, the completed facility retains large quantities of costly stainless steel in the superstructure. These facts raise serious questions about whether further cost savings could have been achieved without compromising program requirements.

36.69 Commitment to emphasize functional requirements with simple and proven approaches not met. In 1994 we identified design features that were not consistent with the commitment made to the Treasury Board to emphasize functional requirements using simple and proven approaches. In its published response, Public Works and Government Services Canada noted that the design and construction were appropriate for a utilitarian building. In our opinion, however, the following examples illustrate that key elements of this project were neither utilitarian nor simple and proven.

36.70 The original stainless steel roof was subsequently redesigned using a less costly material as part of the cost-cutting measures. However, the composition and assembly of the new design were unproven and complex, because no company had ever constructed such a roof and because of its unique layered construction and assembly requirements.

36.71 The "building within a building" design of the Gatineau facility incorporates a concrete structure enclosed by an outer shell consisting of a hanging glass curtain wall and a stainless steel superstructure, as discussed earlier. The

glass curtain wall comprises a size of glazing that restricted the number of potential suppliers and has resulted in problems with specifications, quality control in the manufacture and installation to meet industry standards, and the degradation of thermal properties of the curtain wall.

**36.72** A simpler and less costly exterior finish such as brick, pre-cast concrete or porcelain enamel steel would have avoided these difficulties.

36.73 Extensive landscaping plans scaled back. In 1994 we noted that plans included extensive landscaping to create a park-like setting and to mitigate the imposing nature of the building. There was also a desire to ensure that the building did not look like a warehouse, given its siting within the Gatineau city centre and its proximity to a residential neighbourhood.

**36.74** We are encouraged to report that, since 1994, changes have been made to the landscaping design that have considerably reduced the extent of work done while attempting to maintain the original landscaping objectives. The

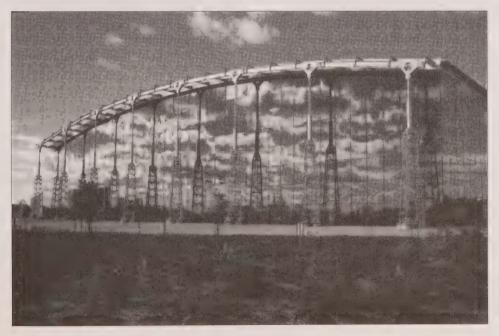
changes were partly in response to our concerns about the magnitude and functionality of this cost element and partly in response to the need to cut \$10 million to meet the project budget.

36.75 In our opinion, however, the original landscaping plans, like the original stainless steel roof, were based on the availability of funding in the project budget, and reduction of the landscaping would not have occurred had there not existed budget or other external pressures to do so.

#### Conclusion

36.76 The National Archives' design objective for the new Gatineau facility has been achieved. The impressive facility makes a striking architectural statement and has received significant positive public attention. The stated objective of creating a facility that provides a safe and secure environment for the long-term storage and ongoing preservation of the country's historic treasures has also been achieved.

**36.77** Although not all costs have been finalized, it now appears that the budget targets have been achieved and that



National Archives of Canada
Gatineau Preservation Centre
— a "building within a
building" design
incorporating a concrete
structure enclosed by an
exterior glass curtain wall
with a roof supported by
stainless steel columns and
superstructure. This building
has no significant public
access role (see
paragraph 36.71)

National Archives of Canada is satisfied that its program requirements have not been significantly compromised as a result of the cost reductions. However, in our opinion, the storage, preservation and active conservation functions, which exclude any significant access to the facility by the public, could have been accommodated in a less expensive building.

36.78 The project approval and budgeting processes set out in the Treasury Board policies for managing capital projects of this magnitude require departments to examine their needs, analyze options available to meet those needs, prepare cost estimates and seek Treasury Board approvals and any adjustments to departmental reference levels to meet the capital or operating and maintenance costs of the new facility.

**36.79** One key element of this process is that the project budget be subjected to a rigorous and meaningful analysis to ensure that it is sufficient but not excessive in supporting the project objectives. In the case of the new Gatineau facility, however, the approved budget exceeded that needed to address the functional requirements of this building, as outlined in the National Archives' project submission and the resulting Treasury Board approvals. The result was a "build [up] to budget" approach that included costly aesthetic elements in the design. It has been recognized that many such projects are built to budget, and that there is a need to change this culture. We would have expected a more rigorous challenge of the design and associated budget by the departments and by the Treasury Board Secretariat.

36.80 In its Eighteenth Report to Parliament in December 1995, the Public Accounts Committee noted that there is more to being a good officeholder than simply following the rules. It maintained that those who hold public office are also

obliged to show regard for the interests of citizens and to protect those interests to the fullest possible extent. In our opinion, the interests of the taxpayer would have been better served by constructing a facility that responded more to the mandate to emphasize functional requirements related to safeguarding and preserving the historic records and less to creating an architectural statement of national significance.

Department's response: The National Archives of Canada - Gatineau Preservation Centre (GPC) project was delivered on time and on budget and fully meets the expectations of all affected parties including the National Archives of Canada, Heritage Canada, the National Capital Commission and the Municipality of Gatineau. Within the project investment and management context of the early 1990s. Public Works and Government Services Canada (PWGSC) delivered a project that met established standards for success (scope, functionality, time, budget) for a project that has been recognized as an "impressive facility" that has received "significant positive comment". However, PWGSC recognizes the concerns raised by the Office of the Auditor General regarding the "build to budget" approach, and is currently working to identify ways to introduce, into the overall contracting process, viable and meaningful incentives for reducing costs.

PWGSC also concurs with the observation that a definitive cost comparison between unique special purpose buildings such as the American NARA II facility and the GPC is difficult.

The location of the GPC is a major element of the cost differential. The criteria governing the site selection and development of the GPC warranted investments that contributed significantly to project costs. Unlike the facility in the United States, the GPC is a significant landmark in the town centre of a major Outouais community within the National Capital Region. PWGSC therefore concurs

with the Office of the Auditor General that the facility has met its objective "to present an image of a leading archival centre, a national heritage and cultural element." PWGSC believes that the broader government objectives affecting the qualitative aspects of investment considerations must be incorporated into the assessment of the project. PWGSC

recognizes that these value-for-money considerations as well as related constraints should be specifically articulated within project approval documentation. PWGSC will reaffirm internal policies accordingly and ensure that future projects explicitly reference such considerations where applicable.

## **Revenue Canada**

Assistant Auditor General: Shahid Minto Responsible Auditor: Alan Gilmore

Revenue Canada departed from departmental standards and practices in awarding a duty free shop licence

Since 1985 Revenue Canada has maintained rigorous standards and practices for the award of duty free shop licences at land border crossings to individuals or corporations. The standards and practices followed by Revenue Canada in the 1995 and 1997 award of a duty free shop licence at one land border crossing differed significantly from those normally used. The precedents set may undermine the transparency and credibility of the duty free shop licence award process. There are conflicting interpretations of a section of the Regulations relating to beneficial ownership. In our opinion, a reasonable case can be made that the awarding of the licences was not done in accordance with the intent of the law.

## **Background**

Revenue Canada is responsible 36.81 for issuing licences for the operation of duty free shops and for monitoring and controlling their ongoing operation. In 1995, Revenue Canada awarded a duty free shop licence in Ontario to an individual at a major land border crossing where there had been a demand for such a shop. Revenue Canada estimated that gross revenue to the duty free shop operator at the site would be approximately \$13.5 million dollars annually. In September 1997, subsequent to the death of the licensee, a new duty free shop licence was awarded to a corporation.

36.82 Since 1985, Revenue Canada has maintained rigorous standards and practices that must be followed in the award of licences to individuals or corporations. These standards and practices are described in the following documents: Customs Act, Duty Free Shop — Regulations; Duty Free Shop — Licensing (Guidelines); the Applicant's Guide and Application; and, in Ontario, the Memorandum of Understanding between Revenue Canada and the Ontario Ministry of Consumer and Commercial

Relations and the Liquor Control Board of Ontario.

36.83 The Regulations and Guidelines require that all applicants meet the following prerequisites before their application is considered. To be eligible, under the Regulations, to operate a licensed facility at a land border crossing, applicants must be Canadian citizens or permanent residents of Canada. A corporation can be considered for a licence at a border crossing if it is incorporated in Canada and all shares are beneficially owned by Canadian citizens or permanent residents of Canada. The Guidelines state that an applicant must qualify as a small-size business or, in exceptional circumstances, as a medium-size business in Canada to be considered to operate a land border crossing duty free shop.

36.84 Applicants who meet these qualifications may submit an application for a licence for the operation of a duty free shop. Revenue Canada selects the successful applicant on the basis of an evaluation and ranking of the individual proposals, which must provide detailed information in seven areas. These include the qualifications of the beneficial owners, the applicant's financial stability, financial

statements presenting detailed three-year forecasts of operational performance, a description of the applicant's management capabilities and retail experience, site and building proposals, a comprehensive business plan, and employment policy.

36.85 No fee is paid to Revenue
Canada for the issuance of a duty free
shop licence; however, a shop pays
Revenue Canada a licence fee based on
a percentage of its annual gross revenue.
Once a duty free shop licence is awarded,
the operator retains the rights to the
licence indefinitely unless proven to be in
breach of the Duty Free Shop Regulations.

#### Issues

- **36.86** In 1995 and 1997, Revenue Canada awarded a duty free shop licence at the same land border crossing in Ontario. We found that the standards and practices used in the award of these duty free shop licences in Ontario differed significantly from those used in other land border crossing licence awards.
- 36.87 In awarding the licences in 1995 and 1997, Revenue Canada departed from its standard duty free shop licence award practices at land border crossings. The information on which Revenue Canada made the award was incomplete and did not address key areas such as business competence and operating practices.
- 36.88 Furthermore, in our opinion, the awards were not consistent with the intent of the Duty Free Shop Regulations' requirement that the ultimate beneficial ownership of a shop rest with Canadian citizens or permanent residents. In both instances, Revenue Canada documentation indicates that the ultimate beneficial ownership rests with a third party that does not qualify to operate a duty free shop because it is a foreign entity.
- **36.89** Revenue Canada explained to us that the circumstances in these awards were unique because the owner of the land at this border crossing refused to lease

- property for a duty free shop to anyone other than the landowner's nominee for the shop. The owner of the land is a foreign-owned Canadian corporation.
- **36.90** Revenue Canada also stated that both licences were awarded in accordance with the law. In our opinion, an equally reasonable case could be made that the licences were not awarded in accordance with the law. This is a matter that only a court could decide conclusively.
- 36.91 Revenue Canada indicated to us that it was faced with a difficult situation. Officials were anxious to fulfil a public need while dealing with a landowner who insisted on his nominee and at the same time complying with Revenue Canada Regulations and Guidelines that provided the officials with limited options.
- 36.92 In contrast with standard practice, there was no national tender call in the award of these duty free shop licences. For all other licence awards since 1985, Revenue Canada has placed a national advertisement inviting applications for the establishment and operation of a land border crossing duty free shop. The applications are reviewed by Revenue Canada staff, a professional accounting firm, and a Selection Advisory Committee. In Ontario, this committee consists of representatives from Revenue Canada, Industry Canada and the Liquor Control Board of Ontario. The granting of a liquor Authorization by the Liquor Control Board is usually made concurrently with the duty free shop licence award.
- 36.93 The awarding of these two licences to operate the duty free shop was non-competitive. All licence awards at other land border crossings were competitively bid. The opportunity to secure a licence at this facility was not made known to the public, even though a number of individuals had expressed a strong interest to Revenue Canada in operating a facility at this site. Further, Revenue Canada did not provide complete and accurate information to some of these

individuals on the availability of a licence at this site. In our opinion, these actions were inconsistent with historical practice, the standards defined in the Duty Free Shop — Licensing Guidelines, the Applicant's Guide and the Memorandum of Understanding.

Revenue Canada proceeded with 36.94 the award of the licences without the agreement of the Province of Ontario as required by a June 1985 Memorandum of Understanding among Revenue Canada, the Ontario Ministry of Consumer and Commercial Relations, and the Liquor Control Board of Ontario. The Memorandum also requires Revenue Canada to "invite applications by national advertisement for the establishment and operation of duty free shops" and to consult and reach a consensus on the selected operator with the Province prior to the award of licences in Ontario.

The licence awards are not 36.95 consistent with the intent of the Duty Free Shop Regulations and Guidelines that beneficial owners be Canadian citizens or permanent residents. In our opinion, the intent of the Duty Free Shop Regulations and Guidelines is to require that all direct or indirect beneficial ownership interest in a duty free shop at a land border crossing be held by individuals who are Canadian citizens or permanent residents. A Canadian corporation may also be awarded a licence if all its shares are beneficially owned by Canadian citizens or permanent residents. The Guidelines state that the "applicant must qualify as a small-size business" or, in exceptional circumstances, as a medium-size business.

36.96 Revenue Canada states that since only the holders of a licence for a land duty free shop need to be Canadian citizens, the issue of beneficial ownership is simply not in question. We disagree with this interpretation since this presents a very restricted view of the intent of the Regulations. The licence awards at this

site are not consistent with the substance of the above-noted requirements. In 1995 the licence was awarded to a Canadian citizen. However, this individual was serving as a nominee for third parties who do not qualify to be awarded a duty free shop licence. Revenue Canada documentation indicates that the ultimate beneficial ownership of the licence appears to rest with a foreign entity. While a Canadian corporation is managing and operating the duty free shop on behalf of the nominee, the corporation does not qualify as a small or medium-size business and, further, it is foreign-owned.

36.97 In 1997, the licence was awarded to a Canadian corporation for the 34 months remaining in the 1995 licence. Revenue Canada documentation indicates that the award was made because "many of the circumstances will remain unchanged with respect to this duty free shop operation, the Department believes this would recognize commitments and interests that were made in good faith by the parties involved."

The corporation shareholders have indicated to Revenue Canada that they are the "true beneficial shareholders". However, in our opinion, Revenue Canada did not obtain sufficient documentation to determine and verify that the shareholders are the true beneficiaries of the licence — that is, whether they are the effective owners with all the benefits and responsibilities associated with ownership as opposed to a situation where the owners function merely as intermediaries. The 1997 licence award was made subsequent to our raising with Revenue Canada our concerns about the 1995 award.

36.99 Revenue Canada did not have sufficient information to ascertain whether the applicants met the qualifications to operate a duty free shop at a land border crossing. The normal practice in the process for awarding duty free shop licences at a land border crossing is for all agreements,

including commercial agreements and information on duty free shop ownership and operation, to be examined by Revenue Canada. The object of the examination is to ascertain whether the applicant is in compliance with the Regulations and Guidelines, and particularly whether the applicant is qualified to operate a duty free shop.

36.100 For the 1995 and 1997 awards, the agreements between the Canadian nominee and the foreign-owned companies relating to ownership structure and the financial, retailing and operating plans for the duty free shop were not fully disclosed to Revenue Canada as required by the Duty Free Shop Licensing Guidelines. The Department states that since a tendering process was not deemed appropriate, information normally required as part of a competitive tendering process was not obtained.

36.101 Revenue Canada documentation for the 1995 licence indicates that the foreign-owned companies entered into a number of agreements. For instance, one established a Canadian-based representative (nominee) who, in return for certain benefits, would hold the licence on their behalf; another involved a contract between the nominee and one of these foreign-owned firms to manage and operate the duty free shop.

36.102 The foreign-owned Canadian company requested that it not be required to disclose its private commercial information, including its agreements. Revenue Canada agreed to this request and thus could not make a fully informed assessment of whether the applicant for the 1995 licence was qualified. For the 1997 licence, similar information was not disclosed to Revenue Canada.

36.103 The 1995 and the 1997 application also did not address whether the applicants met the key business competence requirements of the Duty Free Shop — Licensing Guidelines and Applicant's Guide. For example, for both

the 1995 and 1997 award, the applicant's submissions did not contain a comprehensive business plan or information on the applicant's management capabilities and retail experience. This incomplete application information was accepted by Revenue Canada.

36.104 Revenue Canada informed us that it had deviated from normal licence award practices due to the unique circumstances at this site. Revenue Canada documentation indicates that the foreign-owned Canadian corporation, the owner of the land at the border crossing, refused to lease property for a duty free shop to anyone other than its nominee. This position was accepted by Revenue Canada officials who were anxious to fulfil a public need for a duty free shop at this crossing.

36.105 Conflicting interpretations of the Regulations raise concerns about the intent of the law. Revenue Canada informed us that the 1995 and 1997 licences were awarded in accordance with the Duty Free Shop Regulations. We examined this representation. The relevant sections of the Regulations state:

- 3.(3) A corporation is qualified to operate a duty free shop at a border crossing point if
- (a) the corporation is incorporated in Canada; and
- (b) all the shares of the corporation are beneficially owned by Canadian citizens or permanent residents...
- 3.(4) A person other than a corporation is qualified to operate a duty free shop at a border crossing point if the person
- (a) is a Canadian citizen or permanent resident...

**36.106** The 1995 licence was awarded to an individual. The position of Revenue Canada that the 1995 award was made in accordance with the law would be correct

if the Duty Free Shop Regulations were read strictly and literally, in particular, sub-section 3(4), which does not expressly stipulate that a person who is licensed needs be the beneficial owner of the duty free shop. However, if one were to take the position that the Regulations must be given an interpretation that would best ensure the attainment of the objectives of the Regulations, then, in our opinion, an equally reasonable case could be made that the granting of the 1995 licence was not in accordance with the law. This interpretation would be supported by the interpretation given the Regulations in Revenue Canada's Guidelines for licensing duty free shops at land border crossings. However, only a court could resolve these legal issues conclusively.

36.107 As indicated, in September 1997, a new licence was awarded to a Canadian corporation. Paragraph 3.(3)(b) of the Regulations requires that the beneficial owners of the duty free shop be Canadian citizens or permanent residents. The Canadian shareholders of the corporation wrote to Revenue Canada stating that they are the "true beneficial owners". However, Revenue Canada did not verify this representation. If the beneficial ownership actually rests with a foreign entity, as we think may well be the case, then, in our opinion, the licence award was not made in accordance with the law.

#### Conclusion

36.108 The duty free shop program may have been adversely affected by the precedents set by these licence awards. In awarding the licences discussed above, Revenue Canada did not, for reasons explained earlier, follow certain of its standards and practices for awarding duty free shop licences.

36.109 We are concerned that other individuals, corporations or government agencies who have property ownership or jurisdictional control at land border crossings may now similarly demand that

duty free shop licences be awarded to designated individuals of their choice without a competitive process and without disclosure of their ownership and operating agreements. More important, we are concerned that the manner in which these duty free shop licences were awarded may undermine the transparency and credibility of the duty free shop licence award process.

Department's response: It is the position of the Department that the applicants for the licences in question satisfied all of the requirements under the law and regulations as they pertain to the operation of duty free shops at land border crossings. Moreover, it is our position that the decision to award the licences without recourse to an open tendering process was in full conformity with the law, reflected appropriate judgment in light of the unique circumstances of this case, and in no manner compromised the integrity of the duty free shop program.

*The applicants for the duty free shop* licences submitted documentation demonstrating that they met all of the requirements set out in section 3.0 of the Duty Free Shop Regulations, including the principal requirement that beneficial ownership of the shares of any corporation applying for a duty free shop be held by individuals who are Canadian citizens or permanent residents. This documentation was reviewed thoroughly by departmental officials, in consultation with lawyers from the Department of Justice, and was found to satisfy all of the regulatory requirements. Information normally required as part of a competitive tendering process was neither requested nor required, as a tendering process was not undertaken in this case.

With regard to the Department's decision not to award the licences through a competitive process, it should be noted that there is no statutory or regulatory requirement that a licence for a duty free shop be awarded through a tendering process. Moreover, the case at hand is unique and without precedent. It is the first occasion that the Department has been formally approached by a private interest and asked to award a duty free shop licence to a specific, qualified applicant. Indeed, the owners of the land upon which the duty free shop was to be located stated categorically that they would only provide a lease to their nominee. This being the case, once the nominee was considered to be qualified according to the Regulations, a tendering process was not a viable option. It would not have been in the public's best interest as the outcome was a foregone conclusion.

However, the concerns raised by the Auditor General with respect to the transparency and credibility of the duty free shop licence award process have been duly noted. As a consequence, upon the expiration of the current licence, the Department intends to award any future duty free shop licence at that site through an open, competitive process,

notwithstanding any position the owners of the land may take in advance.

It is the Department's position that the decisions and actions of its officials were entirely in accordance with the law and do not constitute a precedent that would adversely affect the administration of the duty free shop program. Departmental officials exercised prudent judgment in administering the law and regulations in a fair, equitable and impartial manner. There is no evidence to suggest that the actions of our officials jeopardized the integrity of the duty free shop program or were precedent-setting.

Finally, in light of the issues raised by the Auditor General with respect to conflicting interpretations of the regulations and the intent of the law, the Department has undertaken to pursue a full review of the Duty Free Shop Regulations, in concert with the Department of Finance, commencing in January 1998.



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# APPENDIX A AUDITOR GENERAL ACT

R.S.C., c. A-17

An Act respecting the Office of the Auditor General of Canada and sustainable development monitoring and reporting 1995, c. 43, s.1.

#### SHORT TITLE

	SHORT TITLE
Short title	1. This Act may be cited as the <i>Auditor General Act</i> . 1976-77, c. 34, s.1.
	INTERPRETATION
Definitions	2. In this Act,
"appropriate Minister"	"appropriate Minister" has the meaning assigned by section 2 of the Financial Administration Act;
"Auditor General"	"Auditor General" means the Auditor General of Canada appointed pursuant to subsection 3(1);
"category I department"	"category I department" means
	(a) any department named in Schedule I to the Financial Administration Act,
	(b) any department in respect of which a direction has been made under subsection 24(3), and
	(c) any department, as defined in the Financial Administration Act, set out in the schedule;
"Commissioner"	"Commissioner" means the Commissioner of the Environment and Sustainable Development appointed under subsection 15.1(1);
"Crown corporation"	"Crown corporation" has the meaning assigned to that expression by section 83 of the <i>Financial Administration Act</i> ;
"department"	"department" has the meaning assigned to that term by section 2 of the <i>Financial Administration Act</i> ;
"registrar"	"registrar" means the Bank of Canada and a registrar appointed under Part IV of the <i>Financial Administration Act</i> ;
"sustainable development"	"sustainable development" means development that meets the needs of the present without compromising the ability of future generations to meet their own needs;
"sustainable development strategy"	"sustainable development strategy", with respect to a category I department, means the department's objectives, and plans of action, to further sustainable development. 1976-77, c. 34, s. 2; 1984, c. 31, s. 14; 1995, c. 43, s. 2.
	AUDITOR GENERAL OF CANADA

Appointment and tenure of office

3. (1) The Governor in Council shall, by commission under the Great Seal, appoint a qualified auditor to be the officer called the Auditor General of Canada to hold office during good behaviour for a term of ten years, but the Auditor General may be removed by the

Governor in Council on address of the Senate and House of Commons.

Idem

(2) Notwithstanding subsection (1), the Auditor General ceases to hold office on attaining the age of sixty-five years.

Re-appointment

(3) Once having served as the Auditor General, a person is not eligible for re-appointment to that office.

Vacancy

(4) In the event of the absence or incapacity of the Auditor General or if the office of Auditor General is vacant, the Governor in Council may appoint a person temporarily to perform the duties of Auditor General. 1976-77, c. 34, s. 3.

Salary

**4.** (1) The Auditor General shall be paid a salary equal to the salary of a puisne judge of the Supreme Court of Canada.

Pension benefits

(2) The provisions of the *Public Service Superannuation Act*, other than those relating to tenure of office, apply to the Auditor General except that a person appointed as Auditor General from outside the Public Service may, by notice in writing given to the President of the Treasury Board not more than sixty days after the date of his appointment as Auditor General, elect to participate in the pension plan provided for in the *Diplomatic Service (Special) Superannuation Act* in which case the provisions of that Act, other than those relating to tenure of office, apply to him and the provisions of the *Public Service Superannuation Act* do not apply to him. 1976-77, c. 34, s. 4; 1980-81-82-83, c. 50, s. 23, c. 55, s. 1.

#### DUTIES

Examination

5. The Auditor General is the auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund and as such shall make such examinations and inquiries as he considers necessary to enable him to report as required by this Act. 1976-77, c. 34, s. 5.

idem

6. The Auditor General shall examine the several financial statements required by section 64 of the *Financial Administration Act* to be included in the Public Accounts, and any other statement that the President of the Treasury Board or the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have. 1976-77, c. 34, s. 6; 1980-81-82-83, c. 170, s. 25.

Annual and additional reports to the House of Commons

- 7. (1) The Auditor General shall report annually to the House of Commons and may make, in addition to any special report made under subsection 8(1) or 19(2) and the Commissioner's report under subsection 23(2), not more than three additional reports in any year to the House of Commons
- (a) on the work of his office; and,
- (b) on whether, in carrying on the work of his office, he received all the information and explanations he required.

1dem

- (2) Each report of the Auditor General under subsection (1) shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that
- (a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

- (b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;
- (c) money has been expended other than for purposes for which it was appropriated by Parliament;
- (d) money has been expended without due regard to economy or efficiency;
- (e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented; or
- (f) money has been expended without due regard to the environmental effects of those expenditures in the context of sustainable development.

Submission of annual report to Speaker and tabling in the House of Commons (3) Each annual report by the Auditor General to the House of Commons shall be submitted to the Speaker of the House of Commons on or before December 31 in the year to which the report relates and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it.

Notice of additional reports to Speaker and tabling in the House of Commons

(4) Where the Auditor General proposes to make an additional report under subsection (1), the Auditor General shall send written notice to the Speaker of the House of Commons of the subject-matter of the proposed report.

Submission of additional reports to Speaker and tabling in the House of Commons (5) Each additional report of the Auditor General to the House of Commons made under subsection (1) shall be submitted to the House of Commons on the expiration of thirty days after the notice is sent pursuant to subsection (4) or any longer period that is specified in the notice and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it. 1976-77, c. 34, s. 7; 1994, c. 32, s. 1 and 2; 1995, c. 43, s. 3.

Special report to the House of Commons

**8.** (1) The Auditor General may make a special report to the House of Commons on any matter of pressing importance or urgency that, in the opinion of the Auditor General, should not be deferred until the presentation of the next report under subsection 7(1).

Submission of reports to Speaker and tabling in the House of Commons (2) Each special report of the Auditor General to the House of Commons made under subsection (1) or 19(2) shall be submitted to the Speaker of the House of Commons and shall be laid before the House of Commons by the Speaker of the House of Commons forthwith after receipt thereof by him, or if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting. 1976-77, c. 34, s. 8; 1994, c. 32, s. 3.

idem

- **9.** The Auditor General shall
- (a) make such examination of the accounts and records of each registrar as he deems necessary, and such other examinations of a registrar's transactions as the Minister of Finance may require, and
- (b) when and to the extent required by the Minister of Finance, participate in the destruction of any redeemed or cancelled securities or unissued reserves of securities authorized to be destroyed under the *Financial Administration Act*,

and he may, by arrangement with a registrar, maintain custody and control, jointly with that registrar, of cancelled and unissued securities. 1976-77, c. 34, s. 9.

Appendix A Auditor General Act

Improper retention of public money

10. Whenever it appears to the Auditor General that any public money has been improperly retained by any person, he shall forthwith report the circumstances of the case to the President of the Treasury Board. 1976-77, c. 34, s.10.

Inquiry and report

11. The Auditor General may, if in his opinion such an assignment does not interfere with his primary responsibilities, whenever the Governor in Council so requests, inquire into and report on any matter relating to the financial affairs of Canada or to public property or inquire into and report on any person or organization that has received financial aid from the Government of Canada or in respect of which financial aid from the Government of Canada is sought. 1976-77, c. 34, s. 11.

Advisory powers

12. The Auditor General may advise appropriate officers and employees in the public service of Canada of matters discovered in his examinations and, in particular, may draw any such matter to the attention of officers and employees engaged in the conduct of the business of the Treasury Board. 1976-77, c. 34, s. 12.

#### ACCESS TO INFORMATION

Access to information 13. (1) Except as provided by any other Act of Parliament that expressly refers to this subsection, the Auditor General is entitled to free access at all convenient times to information that relates to the fulfilment of his responsibilities and he is also entitled to require and receive from members of the public service of Canada such information, reports and explanations as he deems necessary for that purpose.

Stationing of officers in departments

(2) In order to carry out his duties more effectively, the Auditor General may station in any department any person employed in his office, and the department shall provide the necessary office accommodation for any person so stationed.

Oath of secrecy

(3) The Auditor General shall require every person employed in his office who is to examine the accounts of a department or of a Crown corporation pursuant to this Act to comply with any security requirements applicable to, and to take any oath of secrecy required to be taken by, persons employed in that department or Crown corporation.

Inquiries

(4) The Auditor General may examine any person on oath on any matter pertaining to any account subject to audit by him and for the purposes of any such examination the Auditor General may exercise all the powers of a commissioner under Part I of the *Inquiries Act*. 1976-77, c. 34, s.13.

Reliance on audit reports of Crown corporations

14. (1) Notwithstanding subsections (2) and (3), in order to fulfil his responsibilities as the auditor of the accounts of Canada, the Auditor General may rely on the report of the duly appointed auditor of a Crown corporation or of any subsidiary of a Crown corporation.

Auditor General may request information

(2) The Auditor General may request a Crown corporation to obtain and furnish to him such information and explanations from its present or former directors, officers, employees, agents and auditors or those of any of its subsidiaries as are, in his opinion, necessary to enable him to fulfil his responsibilities as the auditor of the accounts of Canada.

Direction of the Governor in Council

(3) If, in the opinion of the Auditor General, a Crown corporation, in response to a request made under subsection (2), fails to provide any or sufficient information or explanations, he may so advise the Governor in Council, who may thereupon direct the officers of the corporation to furnish the Auditor General with such information and explanations and to give him access to those records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries access to which is, in the opinion of the Auditor General, necessary for him to fulfil his responsibilities as the auditor of the accounts of Canada. 1976-77, c. 34, s. 14.

#### STAFF OF THE AUDITOR GENERAL

#### Officers, etc.

**15.** (1) Such officers and employees as are necessary to enable the Auditor General to perform his duties shall be appointed in accordance with the *Public Service Employment Act*.

# Contract for professional services

(2) Subject to any other Act of Parliament or regulations made thereunder, but without the approval of the Treasury Board, the Auditor General may, within the total dollar limitations established for his office in appropriation Acts, contract for professional services.

#### Delegation to Auditor General

(3) The Auditor General may exercise and perform, in such manner and subject to such terms and conditions as the Public Service Commission directs, the powers, duties and functions of the Public Service Commission under the *Public Service Employment Act*, other than the powers, duties and functions of the Commission in relation to appeals under section 21 of that Act and inquiries under section 34 of that Act.

#### Suspension

(4) The Auditor General may suspend from the performance of his duty any person employed in his office. 1976-77, c. 34, s. 15; 1992, c. 54, s. 79.

## **Appointment of Commissioner**

**15.1** (1) The Auditor General shall, in accordance with the *Public Service Employment Act*, appoint a senior officer to be called the Commissioner of the Environment and Sustainable Development who shall report directly to the Auditor General.

## Commissioner's duties

(2) The Commissioner shall assist the Auditor General in performing the duties of the Auditor General set out in this Act that relate to the environment and sustainable development. 1995, c. 43, s. 4.

#### Responsibility for personnel management

16. In respect of persons employed in his office, the Auditor General is authorized to exercise the powers and perform the duties and functions of the Treasury Board under the *Financial Administration Act* that relate to personnel management including the determination of terms and conditions of employment and the responsibility for employer and employee relations, within the meaning of paragraph 7(1)(e) and sections 11 to 13 of that Act. 1976-77, c. 34, s.16.

## Classification standards

17. Classification standards may be prepared for persons employed in the office of the Auditor General to conform with the classifications that the Auditor General recognizes for the purposes of that office. 1976-77, c. 34, s. 18.

#### Delegation

18. The Auditor General may designate a senior member of his staff to sign on his behalf any opinion that he is required to give and any report, other than his annual report on the financial statements of Canada made pursuant to section 64 of the *Financial Administration Act* and his reports to the House of Commons under this Act, and any member so signing an opinion or report shall indicate beneath his signature his position in the office of the Auditor General and the fact that he is signing on behalf of the Auditor General. 1976-77, c. 34, s. 19.

#### **ESTIMATES**

#### **Estimates**

19. (1) The Auditor General shall annually prepare an estimate of the sums that will be required to be provided by Parliament for the payment of the salaries, allowances and expenses of his office during the next ensuing fiscal year.

#### Special report

(2) The Auditor General may make a special report to the House of Commons in the event that amounts provided for his office in the estimates submitted to Parliament are, in his opinion, inadequate to enable him to fulfil the responsibilities of his office. 1976-77, c. 34, s. 20.

## Appropriation allotments

20. The provisions of the *Financial Administration Act* with respect to the division of appropriations into allotments do not apply in respect of appropriations for the office of the Auditor General. 1976-77, c. 34, s. 21.

#### AUDIT OF THE OFFICE OF THE AUDITOR GENERAL

## Audit of the office of the Auditor General

21. (1) A qualified auditor nominated by the Treasury Board shall examine the receipts and disbursements of the office of the Auditor General and shall report annually the outcome of his examinations to the House of Commons.

# Submission of reports and tabling

(2) Each report referred to in subsection (1) shall be submitted to the President of the Treasury Board on or before the 31st day of December in the year to which the report relates and the President of the Treasury Board shall lay each such report before the House of Commons within fifteen days after receipt thereof by him or, if that House is not then sitting, on any of the first fifteen days next thereafter that the House of Commons is sitting. 1976-77, c. 34, s. 22.

#### SUSTAINABLE DEVELOPMENT

#### Purpose

- 21.1 The purpose of the Commissioner is to provide sustainable development monitoring and reporting on the progress of category I departments towards sustainable development, which is a continually evolving concept based on the integration of social, economic and environmental concerns, and which may be achieved by, among other things,
- (a) the integration of the environment and the economy;
- (b) protecting the health of Canadians;
- (c) protecting ecosystems;
- (d) meeting international obligations;
- (e) promoting equity;
- (f) an integrated approach to planning and making decisions that takes into account the environmental and natural resource costs of different economic options and the economic costs of different environmental and natural resource options;
- (g) preventing pollution; and
- (h) respect for nature and the needs of future generations. 1995, c. 43, s. 5.

#### Petitions received

22. (1) Where the Auditor General receives a petition in writing from a resident of Canada about an environmental matter in the context of sustainable development that is the responsibility of a category I department, the Auditor General shall make a record of the petition and forward the petition within fifteen days after the day on which it is received to the appropriate Minister for the department.

## Acknowledgement to be sent

(2) Within fifteen days after the day on which the Minister receives the petition from the Auditor General, the Minister shall send to the person who made the petition an acknowledgement of receipt of the petition and shall send a copy of the acknowledgement to the Auditor General.

#### Minister to respond

- (3) The Minister shall consider the petition and send to the person who made it a reply that responds to it, and shall send a copy of the reply to the Auditor General, within
- (a) one hundred and twenty days after the day on which the Minister receives the petition from the Auditor General; or
- (b) any longer time, where the Minister personally, within those one hundred and twenty days, notifies the person who made the petition that it is not possible to reply within those one hundred and twenty days and sends a copy of that notification to the Auditor General.

#### Multiple petitioners

(4) Where the petition is from more that one person, it is sufficient for the Minister to send the acknowledgement and reply, and the notification, if any, to one or more of the petitioners rather than to all of them. 1995, c. 43, s. 5.

#### **Duty to monitor**

- 23. (1) The Commissioner shall make any examinations and inquiries that the Commissioner considers necessary in order to monitor
- (a) the extent to which category I departments have met the objectives, and implemented the plans, set out in their sustainable development strategies laid before the House of Commons under section 24; and
- (b) the replies by Ministers required by subsection 22(3).

## Commissioner's report

- (2) The Commissioner shall, on behalf of the Auditor General, report annually to the House of Commons concerning anything that the Commissioner considers should be brought to the attention of that House in relation to environmental and other aspects of sustainable development, including
- (a) the extent to which category I departments have met the objectives, and implemented the plans, set out in their sustainable development strategies laid before that House under section 24;
- (b) the number of petitions recorded as required by subsection 22(1), the subject-matter of the petitions and their status; and
- (c) the exercising of the authority of the Governor in Council under any of subsections 24(3) to (5).

## Submission and tabling of report

(3) The report required by subsection (2) shall be submitted to the Speaker of the House of Commons and shall be laid before that House by the Speaker on any of the next fifteen days on which that House is sitting after the Speaker receives it. 1995, c. 43, s. 5.

## Strategies to be tabled

- **24.** (1) The appropriate Minister for each category I department shall cause the department to prepare a sustainable development strategy for the department and shall cause the strategy to be laid before the House of Commons
- (a) within two years after this subsection comes into force; or
- (b) in the case of a department that becomes a category I department on a day after this subsection comes into force, before the earlier of the second anniversary of that day and a day fixed by the Governor in Council pursuant to subsection (4).

## Updated strategies to be tabled

(2) The appropriate Minister for the category I department shall cause the department's sustainable development strategy to be updated at least every three years and shall cause each updated strategy to be laid before the House of Commons on any of the next fifteen days on which that House is sitting after the strategy is updated.

Appendix A Auditor General Act

Governor in Council direction

(3) The Governor in Council may, on that recommendation of the appropriate Minister for a department not named in Schedule I to the *Financial Administration Act*, direct that the requirements of subsections (1) and (2) apply in respect of the department.

Date fixed by Governor in Council (4) On the recommendation of the appropriate Minister for a department that becomes a category I department after this subsection comes into force, the Governor in Council may, for the purpose of subsection (1), fix the day before which the sustainable development strategy of the department shall be laid before the House of Commons.

Regulations

(5) The Governor in Council may, on the recommendation of the Minister of the Environment, make regulations prescribing the form in which sustainable development strategies are to be prepared and the information required to be contained in them. 1995, c. 43, s. 5.

### APPENDIX B

# **FINANCIAL ADMINISTRATION ACT**

R.S., c. F-11

#### **Extracts from Part X**

### **CROWN CORPORATIONS**

#### **Financial Management**

# Books and systems

- 131. (1) Each parent Crown corporation shall cause
- (a) books of account and records in relation thereto to be kept, and
- (b) financial and management control and information systems and management practices to be maintained,

in respect of itself and each of its wholly-owned subsidiaries, if any.

#### Idem

- (2) The books, records, systems and practices referred to in subsection (1) shall be kept and maintained in such manner as will provide reasonable assurance that
- (a) the assets of the corporation and each subsidiary are safeguarded and controlled;
- (b) the transactions of the corporation and each subsidiary are in accordance with this Part, the regulations, the charter and by–laws of the corporation or subsidiary and any directive given to the corporation; and
- (c) the financial, human and physical resources of the corporation and each subsidiary are managed economically and efficiently and the operations of the corporation and each subsidiary are carried out effectively.

#### Internal audit

(3) Each parent Crown corporation shall cause internal audits to be conducted, in respect of itself and each of its wholly–owned subsidiaries, if any, to assess compliance with subsections (1) and (2), unless the Governor in Council is of the opinion that the benefits to be derived from those audits do not justify their cost.

## Financial statements

(4) Each parent Crown corporation shall cause financial statements to be prepared annually, in respect of itself and its wholly—owned subsidiaries, if any, in accordance with generally accepted accounting principles as supplemented or augmented by regulations made pursuant to subsection (6) if any.

# Form of financial statements

(5) The financial statements of a parent Crown corporation and of a wholly-owned subsidiary shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation or subsidiary.

#### Regulations

(6) The Treasury Board may, for the purposes of subsection (4), make regulations respecting financial statements either generally or in respect of any specified parent Crown corporation or any parent Crown corporation of a specified class, but such regulations shall, in

respect of the preparation of financial statements, only supplement or augment generally accepted accounting principles. 1991, c. 24, s. 41.

#### **Auditor's Reports**

# Annual auditor's report

- 132. (1) Each parent Crown corporation shall cause an annual auditor's report to be prepared, in respect of itself and its wholly—owned subsidiaries, if any, in accordance with the regulations, on
- (a) the financial statements referred to in section 131 and any revised financial statement referred to in subsection 133(3); and
- (b) any quantitative information required to be audited pursuant to subsection (5).

#### Contents

- (2) A report under subsection (1) shall be addressed to the appropriate Minister and shall
- (a) include separate statements, whether in the auditor's opinion,
  - (i) the financial statements are presented fairly in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year,
  - (ii) the quantitative information is accurate in all material respects and, if applicable, was prepared on a basis consistent with that of the preceding year, and
  - (iii) the transactions of the corporation and of each subsidiary that have come to his notice in the course of the auditor's examination for the report were in accordance with this Part, the regulations, the charter and by–laws of the corporation or subsidiary and any directive given to the corporation; and
- (b) call attention to any other matter falling within the scope of the auditor's examination for the report that, in his opinion, should be brought to the attention of Parliament.

#### Regulations

(3) The Treasury Board may make regulations prescribing the form and manner in which the report referred to in subsection (1) is to be prepared.

#### Separate reports

(4) Notwithstanding any other provision of this Part, the auditor of a parent Crown corporation may prepare separate annual auditor's reports on the statements referred to in paragraph (1)(a) and on the information referred to in paragraph (1)(b) if, in the auditor's opinion, separate reports would be more appropriate.

#### Audit of quantitative information

(5) The Treasury Board may require that any quantitative information required to be included in a parent Crown corporation's annual report pursuant to subsection 150(3) be audited.

#### Other reports

(6) The auditor of a parent Crown corporation shall prepare such other reports respecting the corporation or any wholly—owned subsidiary of the corporation as the Governor in Council may require.

#### Examination

(7) An auditor shall make such examination as he considers necessary to enable him to prepare a report under subsection (1) or (6).

Reliance on internal audit

(8) An auditor shall, to the extent he considers practicable, rely on any internal audit of the corporation being audited that is conducted pursuant to subsection 131(3). 1991, c. 24, s. 42.

Errors and omissions

133. (1) A director or officer of a Crown corporation shall forthwith notify the auditor and the audit committee of the corporation, if any, of any error or omission of which the director or officer becomes aware in a financial statement that the auditor or a former auditor has reported on or in a report prepared by the auditor or a former auditor pursuant to section 132.

Idem

(2) Where an auditor or former auditor of a Crown corporation is notified or becomes aware of any error or omission in a financial statement that the auditor or former auditor has reported on or in a report prepared by the auditor or former auditor pursuant to section 132, he shall forthwith notify each director of the corporation of the error or omission if he is of the opinion that the error or omission is material.

Correction

(3) Where an auditor or former auditor of a Crown corporation notifies the directors of an error or omission in a financial statement or report pursuant to subsection (2), the corporation shall prepare a revised financial statement or the auditor or former auditor shall issue a correction to the report, as the case may be, and a copy thereof shall be given to the appropriate Minister. 1984, c. 31, s. 11.

#### **Auditors**

Appointment of auditor

134. (1) The auditor of a parent Crown corporation shall be appointed annually by the Governor in Council, after the appropriate Minister has consulted the board of directors of the corporation, and may be removed at any time by the Governor in Council, after the appropriate Minister has consulted the board.

**Auditor General** 

(2) On and after January 1, 1989, the Auditor General of Canada shall be appointed by the Governor in Council as the auditor, or a joint auditor, of each parent Crown corporation named in Part I of Schedule III, unless the Auditor General waives the requirement that he be so appointed.

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(3) Subsections (1) and (2) do not apply in respect of any parent Crown corporation the auditor of which is specified by any other Act of Parliament to be the Auditor General of Canada, but the Auditor General is eligible to be appointed the auditor, or a joint auditor, of a parent Crown corporation pursuant to subsection (1) and section 135 does not apply to him.

**Exception** 

(4) Notwithstanding subsection (1), where the report referred to in subsection 132(1) is to be prepared in respect of a wholly—owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the auditor of the subsidiary, and subsections (6) and sections 135 to 137 apply in respect of that auditor as though the references therein to a parent Crown corporation were references to the subsidiary.

Criteria for appointment

(5) The Governor in Council may make regulations prescribing the criteria to be applied in selecting an auditor for appointment pursuant to subsection (1) or (4).

Re-appointment

(6) An auditor of a parent Crown corporation is eligible for re–appointment on the expiration of his appointment.

Continuation in office

(7) Notwithstanding subsection (1), if an auditor of a parent Crown corporation is not appointed to take office on the expiration of the appointment of an incumbent auditor, the incumbent auditor continues in office until his successor is appointed. 1984, c.31, s.11.

Persons not eligible

135. (1) A person is disqualified from being appointed or re–appointed or continuing as an auditor of a parent Crown corporation pursuant to section 134 if that person is not independent of the corporation, any of its affiliates, or the directors or officers of the corporation or any of its affiliates.

Independence

- (2) For the purpose of this section,
- (a) independence is a question of fact; and
- (b) a person is deemed not to be independent if that person or any of his business partners
  - (i) is a business partner, director, officer or employee of the parent Crown corporation or any of its affiliates, or a business partner of any director, officer or employee of the corporation or any of its affiliates,
  - (ii) beneficially owns or controls, directly or indirectly through a trustee, legal representative, agent or other intermediary, a material interest in the shares or debt of the parent Crown corporation or any of its affiliates, or
  - (iii) has been a receiver, receiver—manager, liquidator or trustee in bankruptcy of the parent Crown corporation or any of its affiliates within two years of his proposed appointment as auditor of the corporation.

Resignation

(3) An auditor of a parent Crown corporation who becomes disqualified under this section shall resign forthwith after becoming aware of his disqualification. 1984, c.31, s.11.

Qualifications preserved

136. Nothing in sections 134 and 135 shall be construed as empowering the appointment, re–appointment or continuation in office as an auditor of a parent Crown corporation of any person who does not meet any qualifications for such appointment, re–appointment or continuation established by any other Act of Parliament. 1984, c. 31, s. 11.

Resignation

137. A resignation of an auditor of a parent Crown corporation becomes effective at the time the corporation receives a written resignation from the auditor or at the time specified in the resignation, whichever is later. 1984, c. 31, s. 11.

#### **Special Examination**

Special examination

138. (1) Each parent Crown corporation shall cause a special examination to be carried out in respect of itself and its wholly—owned subsidiaries, if any, to determine if the systems and practices referred to in paragraph 131(1)(b) were, in the period under examination, maintained in a manner that provided reasonable assurance that they met the requirements of paragraphs 131(2)(a) and (c).

Time for examination

(2) A special examination shall be carried out at least once every five years and at such additional times as the Governor in Council, the appropriate Minister or the board of directors of the corporation to be examined may require.

Plan

(3) Before an examiner commences a special examination, he shall survey the systems and practices of the corporation to be examined and submit a plan for the examination, including a statement of the criteria to be applied in the examination, to the audit committee of the corporation, or if there is no audit committee, to the board of directors of the corporation.

## Resolution of disagreements

- (4) Any disagreement between the examiner and the audit committee or board of directors of a corporation with respect to a plan referred to in subsection (3) may be resolved
- (a) in the case of a parent Crown corporation, by the appropriate Minister; and
- (b) in the case of a wholly—owned subsidiary, by the parent Crown corporation that wholly owns the subsidiary.

## Reliance on internal audit

(5) An examiner shall, to the extent he considers practicable, rely on any internal audit of the corporation being examined conducted pursuant to subsection 131(3). 1984, c.31, s.11.

#### Report

139. (1) An examiner shall, on completion of the special examination, submit a report on his findings to the board of directors of the corporation examined.

#### Contents

- (2) The report of an examiner under subsection (1) shall include
- (a) a statement, whether in the examiner's opinion, with respect to the criteria established pursuant to subsection 138(3), there is reasonable assurance that there are no significant deficiencies in the systems and practices examined; and
- (b) a statement of the extent to which the examiner relied on internal audits. 1984, c.31, s.11.

#### Special report of appropriate Minister

140. Where the examiner of a parent Crown corporation, or a wholly owned subsidiary of a parent Crown corporation, named in Part I of Schedule III is of the opinion that his report under subsection 139(1) contains information that should be brought to the attention of the appropriate Minister, he shall, after consultation with the board of directors of the corporation, or with the board of the subsidiary and corporation, as the case may be, report that information to the Minister and furnish the board or boards with a copy of the report. 1984, c.31, s.11.

#### Special report to Parliament

141. Where the examiner of a parent Crown corporation, or a wholly—owned subsidiary of a parent Crown corporation, named in Part I of Schedule III of the opinion that his report under subsection 139(1) contains information that should be brought to the attention of Parliament, he shall, after consultation with the appropriate Minister and the board of directors of the corporation, or with the boards of the subsidiary and corporation, as the case may be, prepare a report thereon for inclusion in the next annual report of the corporation and furnish the board or boards, the appropriate Minister and the Auditor General of Canada with copies of the report. 1984, c.31, s.11.

#### Examiner

142. (1) Subject to subsections (2) and (3), a special examination referred to in section 138 shall be carried out by the auditor of a parent Crown corporation.

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(2) Where, in the opinion of the Governor in Council, a person other than the auditor of a parent Crown corporation should carry out a special examination, the Governor in Council may, after the appropriate Minister has consulted the board of directors of the corporation, appoint an auditor who is qualified for the purpose to carry out the examination in lieu of the

auditor of the corporation and may, after the appropriate Minister has consulted the board, remove that qualified auditor at any time.

#### Exception

(3) Where a special examination is to be carried out in respect of a wholly—owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the qualified auditor who is to carry out the special examination.

## Applicable provisions

(4) Subject to subsection (5), sections 135 and 137 apply in respect of an examiner as though the references therein to an auditor were references to an examiner.

## Auditor General eligible

(5) The Auditor General of Canada is eligible to be appointed an examiner and section 135 does not apply to the Auditor General of Canada in respect of such an appointment. 1984, c. 31, s. 11.

#### Consultation with Auditor General

## Consultation with Auditor General

143. The auditor or examiner of a Crown corporation may at any time consult the Auditor General of Canada on any matter relating to his audit or special examination and shall consult the Auditor General with respect to any matter that, in the opinion of the auditor or examiner, should be brought to the attention of Parliament pursuant to paragraph 132(2)(b) or section 141. 1984, c. 31, s. 11.

#### **Right to Information**

#### Right to Information

- 144. (1) On the demand of the auditor or examiner of a Crown corporation, the present or former directors, officers, employees or agents of the corporation shall furnish such
- (a) information and explanations, and
- (b) access to records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries

as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the directors, officers, employees or agents are reasonably able to furnish.

#### Idem

- (2) On the demand of the auditor or examiner of a Crown corporation, the directors of the corporation shall
- (a) obtain from the present or former directors, officers, employees or agents of any subsidiary of the corporation such information and explanations as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the present or former directors, officers, employees or agents are reasonably able to furnish; and
- (b) furnish the auditor or examiner with the information and explanations so obtained.

## Reliance on reports

(3) An auditor or examiner of a Crown corporation may reasonably rely on any report of any other auditor or examiner. 1984, c. 31, s. 11.

#### **Policy**

#### Restriction

- 145. Nothing in this Part or the regulations shall be construed as authorizing the auditor or examiner of a Crown corporation to express any opinion on the merits of policy, including the merits of
- (a) the objects or purposes for which the corporation is incorporated, or the restrictions on the businesses or activities that it may carry on, as set out in its charter;
- (b) the objectives of the corporation; and
- (c) any business or policy decision of the corporation or of the Government of Canada. 1984, c. 31, s. 11.

#### **Qualified Privilege**

## Qualified privilege

146. Any oral or written statement or report made under this Part or the regulations by the auditor or a former auditor, or the examiner or a former examiner, of a parent Crown corporation or a wholly—owned subsidiary has qualified privilege. 1991, c. 24, s. 43.

#### **Costs**

## Cost of audit and examination

147. (1) The amounts paid to an auditor or examiner of a Crown corporation for preparing any report under section 132, 139, 140 or 141 shall be reported to the President of the Treasury Board.

#### Idem

(2) Where the Auditor General of Canada is the auditor or examiner of a Crown corporation, the costs incurred by him in preparing any report under section 132, 139, 140 or 141 shall be disclosed in the next annual report of the Auditor General and be paid out of the moneys appropriated for his office. 1984, c. 31, s. 11.

#### **Audit Committee**

#### **Audit committee**

148. (1) Each parent Crown corporation that has four or more directors shall establish an audit committee composed of not less than three directors of the corporation, the majority of whom are not officers or employees of the corporation or any of its affiliates.

#### Idem

(2) In the case of a parent Crown corporation that has less than four directors, the board of directors of the corporation constitutes the audit committee of the corporation and shall perform the duties and functions assigned to an audit committee by any provision of this Part and the provision shall be construed accordingly.

#### **Duties**

- (3) The audit committee of a parent Crown corporation shall
- (a) review, and advise the board of directors with respect to, the financial statements that are to be included in the annual report of the corporation;
- (b) oversee any internal audit of the corporation that is conducted pursuant to subsection 131(3);

- (c) review, and advise the board of directors with respect to, the annual auditor's report of the corporation referred to in subsection 132(1);
- (d) in the case of a corporation undergoing a special examination, review, and advise the board of directors with respect to, the plan and reports referred to in sections 138 to 141; and
- (e) perform such other functions as are assigned to it by the board of directors or the charter or by–laws of the corporation.

Auditor's or examiner's attendance

(4) The auditor and any examiner of a parent Crown corporation are entitled to receive notice of every meeting of the audit committee and, at the expense of the corporation, to attend and be heard at each meeting; and, if so requested by a member of the audit committee, the auditor or examiner shall attend any or every meeting of the committee held during his term of office.

Calling meeting

(5) The auditor or examiner of a parent Crown corporation or a member of the audit committee may call a meeting of the committee.

Wholly-owned subsidiary

- (6) Where the report referred to in subsection 132(1) is to be prepared in respect of a wholly–owned subsidiary separately, subsections (1) to (5) apply, with such modifications as the circumstances require, in respect of the subsidiary as though
- (a) the references in subsections (1) to (5) to a parent Crown corporation were references to the subsidiary; and
- (b) the reference in paragraph (3)(a) to the annual report of the corporation were a reference to the annual report of the parent Crown corporation that wholly owns the subsidiary. 1984, c. 31, s. 11.

#### Reports

Accounts, etc. to Treasury Board or appropriate Minister 149. (1) A parent Crown corporation shall provide the Treasury Board or the appropriate Minister with such accounts, budgets, returns, statements, documents, records, books, reports or other information as the Board or appropriate Minister may require.

Reports on material developments

(2) The chief executive officer of a parent Crown corporation shall, as soon as reasonably practicable, notify the appropriate Minister, the President of the Treasury Board and any director of the corporation not already aware thereof of any financial or other developments that, in the chief executive officer's opinion, are likely to have a material effect on the performance of the corporation, including its wholly—owned subsidiaries, if any, relative to the corporation's objectives or on the corporation's requirements for funding.

Reports on wholly-owned subsidiaries

(3) Each parent Crown corporation shall forthwith notify the appropriate Minister and the President of the Treasury Board of the name of any corporation that becomes or ceases to be a wholly—owned subsidiary of the corporation. 1984, c. 31, s. 11.

Annual report

150. (1) Each parent Crown corporation shall, as soon as possible, but in any case within three months, after the termination of each financial year submit an annual report on the operations of the corporation in that year concurrently to the appropriate Minister and the President of the Treasury Board, and the appropriate Minister shall cause a copy of the report to be laid before each House of Parliament on any of the first fifteen days on which that House is sitting after he receives it.

## Reference to committee

(2) An annual report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to the businesses and activities of the corporation submitting the report.

## Form and contents

- (3) The annual report of a parent Crown corporation shall include
- (a) the financial statements of the corporation referred to in section 131,
- (b) the annual auditor's report referred to in subsection 132(1),
- (c) a statement on the extent to which the corporation has met its objectives for the financial year,
- (d) such quantitative information respecting the performance of the corporation, including its wholly–owned subsidiaries, if any, relative to the corporation's objectives as the Treasury Board may require to be included in the annual report, and
- (e) such other information as is required by this or any other Act of Parliament, or by the appropriate Minister, the President of the Treasury Board or the Minister of Finance, to be included in the annual report,

and shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation and its wholly—owned subsidiaries, if any.

#### Idem

(4) In addition to any other requirements under this Act or any other Act of Parliament, the Treasury Board may, by regulation, prescribe the information to be included in annual reports and the form in which such information is to be prepared. 1991, c. 24, s. 49.

# Annual consolidated report

151. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause a copy of an annual consolidated report on the businesses and activities of all parent Crown corporations for their financial years ending on or before the previous July 31 to be laid before each House of Parliament.

## Reference to committee

(2) An annual consolidated report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to Crown corporations.

#### Contents

- (3) The annual consolidated report referred to in subsection (1) shall include
- (a) a list naming, as of a specified date, all Crown corporations and all corporations of which any shares are held by, on behalf of or in trust for the Crown or any Crown corporation;
- (b) employment and financial data, including aggregate borrowings of parent Crown corporations; and
- (c) such other information as the President of the Treasury Board may determine. 1984, c. 31, s. 11.

#### **Annual report**

152. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause to be laid before each House of Parliament a copy of a report indicating the

summaries and annual reports that under this Part were to be laid before that House by July 31 in that year, the time at, before or within which they were to be laid and the time they were laid before that House.

Attest

(2) The accuracy of the information contained in the report referred to in subsection (1) shall be attested by the Auditor General of Canada in the Auditor General's report to the House of Commons. 1991, c. 24, s. 44.

# APPENDIX C REPORTS TO THE HOUSE

## Monday, 28 October 1996

## The Standing Committee on Public Accounts has the honour to present its

#### THIRD REPORT

Pursuant to Standing Order 108(3)(d), your Committee has studied Chapter 1 of the Auditor General's May 1996 Report (Other Audit Observations — Revenue Canada). The Committee held meetings on this subject with representatives from the Departments of Finance, Revenue Canada and the Office of the Auditor General on May 16 and October 2, 1996.

#### Introduction

The Standing Committee on Public Accounts thanks the Auditor General for his report and for his willingness to appear before the Committee on several occasions. In particular, the Committee would like to thank the Auditor General for bringing to our attention the issue of Taxable Canadian Property and the decision that was made in December, 1991.

The Committee acknowledges the important work of the Auditor General and expresses appreciation for the productive relationship between the Auditor General and the Committee. The Committee also wishes to thank those who took the time to answer the Committee's questions with regard to Chapter 1 of the May 1996 Auditor General's Report.

The issues raised in Chapter 1 of the May 1996 Auditor General's report concerning the taxation of emigrants were referred to both the Standing Committee on Finance and the Standing Committee on Public Accounts. The Standing Committee on Finance heard from a wide range of witnesses and examined the issues relating both to the process and to the policy related to tax rulings given in 1985 and 1991. The Standing Committee on Finance issued its report in September 1996, with a series of recommendations affecting both the advance rulings process and the policy of the taxation of emigrants.

The Minister of Finance tabled a Notice of Ways and Means Motion on October 2, 1996 which implemented the policy recommendations put forward by the Standing Committee on Finance and tightened Canada's already strict rules for taxpayer migration. The Committee is pleased that the Auditor General expressed satisfaction with the Government's response to the issues raised in his report.

The Standing Committee on Public Accounts notes the Auditor General's remarks with regard to the statement by the Minister of Finance on October 2, 1996:

If I may add my own views on this. I must say that we saw the Minister of Finance's announcement for the first time this afternoon, just before the start of this hearing, so my comments are preliminary comments, and I will need a little more time to review the technical details.

With that qualification, I would nevertheless say that at first glance the response appears to be a fairly thorough response to the concerns that we have raised, and I am pleased by the seriousness with which our concerns have been taken.

It seems as though the changes proposed would definitely clarify the legislation and it also seems that the changes proposed go in the direction that I thought was the basic intent of the law, of the *Income* 

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Tax Act and of Parliament. In fact, very quickly, I noted some of the technical changes very similar to some of the comments we made during testimony to the Finance Committee. I think from what I've seen so far, the changes seem to respond to the concerns that we've expressed before now.

For its part, the Standing Committee on Public Accounts heard from many of the same witnesses who appeared before the Standing Committee on Finance concerning the 1985 and 1991 rulings. From this testimony, there are several issues that the Standing Committee on Public Accounts would like to highlight in this report.

#### Documentation:

The Committee is concerned about the lack of documentation of the December 23, 1991 meetings held by officials to discuss this ruling. The Committee believes that rulings outlining the interpretation of tax policy should be well documented, consistent and transparent.

The Committee is pleased that, in May 1996, when the Minister of National Revenue was made aware of this problem she acted immediately to ensure that all tax policy interpretations are properly documented.

#### Granting of an advance tax ruling:

The Committee also examined whether the advance ruling in 1991 should have been given at all. The Committee notes that in determining whether to give the rulings, Revenue Canada was confronted with ambiguous legislation. The Auditor General, in confirming that the legislation was ambiguous, stated before this Committee: "This observation highlights significant ambiguities in the *Income Tax Act* relating to the concept of taxable Canadian property."

Faced with the ambiguous legislation, Revenue Canada consulted with both the Department of Finance and the Department of Justice. Given that Revenue Canada received advice that a positive ruling would be in accordance with both a proper interpretation of the law and its policy, the Committee believes that Revenue Canada was correct in issuing the advance tax ruling.

#### Integrity of officials involved:

In its investigation of this issue, the Committee found no evidence to doubt the integrity of the officials involved in making this advance ruling. The Committee also notes that the Auditor General said in his testimony to the Committee that:

In the dealings that we've had with Revenue Canada, and particularly since I've been Auditor General we've had a lot of dealings with Revenue Canada, I have never had the occasion or the need to ever question the integrity of the senior officials at Revenue Canada.

#### Recommendations:

- 1. The Committee recommends that the substantive conclusions of the Standing Committee on Finance as outlined in the appendix of the Third Report of the Standing Committee on Finance be adopted.
- 2. The Committee believes that the lack of a system to ensure consistency of rulings, the lack of documentation and the failure to publish rulings were problems which existed at the time that the 1985 and 1991 advance tax rulings were given. However, the Committee notes that changes in the advance rulings process have since been made to address both the concerns of the Auditor General and the recommendations of the Standing Committee on Finance.

The Committee recommends that the Minister of National Revenue ensure that the reforms made to the advance rulings process continue in the future to fully adhere to the goals of transparency, consistency and better documentation.

3. The Committee recommends that following the Minister of National Revenue's announcement that in future all tax policy interpretations be properly documented, that the Minister of National Revenue table the procedure which must now be followed in documenting important decisions.

The dissenting opinions of the Bloc Québécois and the Reform Party, as well as the supplementary opinion of Denis Paradis, are appended to this Report.

Pursuant to Standing Order 109, the Committee requests the Government to table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (Issue No. 2 which includes this Report) is tabled.

Respectfully submitted,

Michel Guimond

Chair

Appendix C PAC Reports

# **Dissenting Opinion — Family Trusts Scandal**

### **Bloc Québécois**

## Institutionalisation of a shameless cover-up

#### Introduction

The tabling of this new report by the Liberal majority of the Public Accounts Committee on the family trusts scandal fits in directly with the government's cover-up of a financial and fiscal scandal unprecedented in Canada. The Public Accounts Committee should shed light on all of the obscure events surrounding the decision of December 23, 1991, leaving the technical part on necessary fiscal changes to the Finance Committee.

Following the uncovering of this scandal, many Liberal committee members displayed outrage at the actions of Revenue Canada and the Finance Department. The unruly Liberal MPs quickly fell into step with the government partisanship which is in every way trying to protect very, very highly-placed interests of which the financial implications are now evident.

#### No lack of integrity?

To justify its ineptitude and its lack of courage, the Liberal majority maintains that the Committee found no element for which to cast doubt on the integrity of bureaucrats involved in the making of this premature decision. (Majority Report, p. 5) Liberal MPs are being hypocritical and even naive in pretending to be able to pass judgement on the integrity of the bureaucrats involved. All of the Liberal MPs' actions during the Committee meetings were a shameless attempt to bury the affair by trying to conceal the facts.

How can they really pretend to be shedding light on this entire scandal? First of all, they refused to let the Committee fulfil its mandate. Then, they refused to let the Committee make use of all of its investigative powers. They also refused the Committee the right to hear from all of the bureaucrats involved. And finally, they allowed the Committee no more than two hearings on this scandal. Shedding all of the light? That was certainly the last thing the Liberal MPs had in mind.

However much the latter try to use the Auditor General's statements (Majority Report, p. 5) to back them up, they deliberately omit to point out that the Auditor General clearly specifies that his office has not conducted an inquiry particularly directed at questions of interference or lack of integrity. His office's inquiry was focused on the technical interpretation given to the interpretation request. (Public Accounts Committee, May 8, 1996 and October 2, 1996)

Now, the role of ensuring the integrity of the public service directly belongs to the Public Accounts Committee, as the guardian of governmental accountability. The Committee's Liberal majority clearly abdicated its responsibilities. In effect, the analysis of some testimonies before the Committee show the blind intentions made evident by the Liberal MPs.

### Inconsistencies, inexactitudes, lapses and differing versions

More than a dozen inconsistencies, inexactitudes, lapses and differing versions have arisen throughout testimonies, notably by the Revenue deputy minister, a key player in the December 23, 1991 decision. In refusing to note one single example, the Liberal MPs have succeeded in institutionalising this scandal by placing at the government's service the sole parliamentary committee responsible for overseeing the machinery of government's accountability. Here are some examples of the Liberal majority's lack of courage and willpower:

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• Firstly, a briefing note written on Sunday, December 22, 1991 by a Revenue Canada employee, on his own initiative, rendered an unfavourable decision with respect to the taxpayer. In commenting on this famous note, the Deputy Minister of Revenue let on that this briefing note was only a routine procedure in the event that an unfavourable decision was rendered. (Public Accounts Committee, October 2, 1996) It turns out that this was the first time that the Auditor General, for whom this note had great importance, had heard this explanation from Revenue Canada, on that same day, during the Committee meeting. (Public Accounts Committee, October 2, 1996) Yet, Revenue Canada and the Auditor General had been working together on this issue for months. The Liberals made no mention of this in their report.

- Next, Revenue Canada usually refuses to render advance income tax rulings on past transactions. Now, the
  Auditor General clearly revealed that Revenue Canada's decision dealt with past transactions. Even at the Committee's last meeting, the differences between Revenue Canada and the Auditor General persisted. Once again,
  no mention in the Liberals' report.
- As well, the Deputy Minister of Revenue acknowledged that fiscal effects of the advance income tax ruling had not been evaluated. So Revenue Canada permitted the transfer of more than \$2 billion to the United States without any tax being paid, and without assessing the possible impact of such an important decision on Canada's tax base. The Liberals refuse to include these serious lapses in their report.
- Furthermore, during the last meeting the Deputy Minister of Revenue swore that the waiver signed by the taxpayer had no legal value, that he could not accurately trace the family trusts in the U.S.. All of these serious lapses and acts place the Canadian tax base in peril. The Liberal majority closes its eyes and still makes no mention of them in its report.
- Finally, on May 16, 1996, the Deputy Minister of Revenue indicated to the Public Accounts Committee that throughout the month of December 1991 he was aware of a debate over the advance income tax ruling of December 23, 1991. However, in his October 2, 1996 testimony before the same committee, the deputy minister indicated to us that he was only informed on December 20, 1991. Coincidentally, the version given on October 2, 1996 corresponded much better with the justification of the famous briefing note of December 22, 1991, which was tabled in committee that same day. Once again, the Liberals deliberately omitted this important detail in their report.

The only thing that is beginning to enlighten Canadians about the family trusts scandal is not what is not found in the Liberal MPs' report, but rather what has been intentionally omitted.

#### Government manipulation

Numerous other examples make the list of inconsistencies, inexactitudes, lapses and differing versions even longer. From the outset of the Committee's work, the Liberal majority, blatantly manipulated by the government, prevented the Public Accounts Committee from shedding light on the entire family trusts scandal.

The majority report is the crowning achievement in this blatant effort by the government to bury this scandal and to silence the truth in order to protect themselves. The government is trying in every possible way to prevent Canadians from knowing the whole truth about these fiscal and financial manoeuvres which have probably cost the Canadian tax system billions of dollars.

The Bloc Québécois MPs also question the attitude of the Deputy Minister of Finance, David Dodge, who in verbally attacking the Auditor General during the Committee's last meeting, overstepped all rules of respect. His unacceptable and disrespectful behaviour demonstrates the government's arrogance towards one of our parliamentary system's most important institutions.

#### Recommendation

It is shameful and, unfortunately for the government, it is far from over. That is why with this dissenting opinion we, the Members of the Bloc Québécois, make the following recommendation:

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That a special commission of inquiry be set up, independant of the government, with the mandate to shed light on all of the events surrounding the December 23, 1991 decision and the subsequent use of this tax loophole by other rich Canadian families.

#### Conclusion

Without an impartial and independant inquiry into all Liberal government partisanship, this scandal will never be brought to light. And if the government has nothing to hide, no one to protect and nothing to reproach itself as it pretends, what is preventing it from setting up such a commission of inquiry which would certainly clear it of any blame. At least, that's what the government has been repeatedly telling us for six months!

Michel Guimond, M.P. Yves Rocheleau, M.P. Pierre de Savoye, M.P.

# Reform Party Dissenting Opinion to the Standing Committee on Public Accounts

## Thursday, 24 October 1996

Respectfully submitted by:

Jim Silye, M.P. John Williams, M.P.

The Reform Party of Canada files this dissenting minority report with reluctance. It was hoped that after the review and questioning of witnesses on Chapter 1 of the May 1996 Auditor General's Report, Committee members would reach a consensus and file a unanimous report. Unfortunately, all three parties drew different conclusions.

The Auditor General raised the issues of emigrant taxation of taxable Canadian property when exiting Canada and the advance tax ruling process in his audit of May 1996.

The majority report is fair in its comments concerning the steps taken by the Department of Finance to clarify the existing ambiguous tax legislation on emigrant taxation and closing the loopholes on the taxation of Canadian property upon the departure of a taxpayer from Canada.

However, when it came to critiquing what happened in 1991, the majority report fails or neglects certain facts and, thereby, draws very different conclusions than ours.

Under the section, Documentation, the report expresses concern about the lack of documentation but does not explain why. The paper trail in Revenue Canada was clear and ample, up to, but not including, the meetings of December 23, 1991, the day the final decision was rendered. No notes were made of several meetings that took place that day.

This final decision was a reversal of all the opinions documented prior to December 23, 1991, which clearly showed that Revenue Canada was opposed to a ruling in the taxpayer's favour.

Memoranda of December 18, 1991, and December 20, 1991, written by senior officials to the Deputy Minister of National Revenue advised him that the Department was unable to rule favourably. In fact, even the Revenue Canada Rulings Review Committee on December 12, 1991, decided that a favourable ruling should not be provided.

Due to the lack of minutes for the December 23, 1991, meetings where Finance and Justice apparently were able to resolve the policy issue and the legal issues, there is no evidence of contrary arguments considered and there is no bridging of the recommendations reached up to that date to provide an unfavourable ruling with other analysis and documentation. The Auditor General had serious concerns that the tax ruling on the transaction may have circumvented the intent of the law.

Furthermore, the evidence shows that to put the transaction "on side", Revenue Canada issued the favourable ruling upon the condition that the taxpayer provide a waiver and an undertaking not to invoke the tax treaty between Canada and the United States. This clearly shows that revenue Canada up to December 23, 1991, was correct in believing that the transactions intended to circumvent the law's intent. But what happened on December 23, 1991???

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The Auditor General also raised the question: in light of the fact that the taxpayer had already completed part of the transaction, did the department officials violate policy on advance income tax rulings? Once a transaction is completed, Revenue Canada cannot give an advance ruling — because what's done is done.

The majority report tries to absolve department officials on the grounds of ambiguous legislation. Department officials claim that they were looking at proposed transactions. However, department officials admitted that an agreement was made with the taxpayer to bring the transaction "on side", in other words, re-working the transaction supported by a waiver and an undertaking by the taxpayer. This side agreement to the ruling only goes to prove that, in fact, the transaction had been completed and, therefore, it appears that an advance tax ruling was inappropriate and in violation of department policy, and should not have been given.

This ruling was a mistake on the part of department officials and unfair to subsequent taxpayers, particularly in light of the fact that the tax ruling was not made public for many years. Consequently, other taxpayers were denied knowledge of the department's actions and the benefit available to those who received the ruling. When the ruling was published, the requirement of the waiver and undertaking was withheld.

In our criticism of the department's handling of this incident, we are in no way imputing motive or questioning the integrity of the officials involved nor of any impropriety on the part of any official in making this ruling, but we do believe they erred in their final decision and that the decision-making process was flawed.

We believe that Revenue Canada, in consultation with the Department of Finance and the Department of Justice, should have informed the taxpayer that the ruling requested was not possible because the disposing trust had not been a resident of Canada for ten years prior to the disposition; therefore, the capital gains were taxable when the asset was transferred to another country.

We believe that Revenue Canada should not have ruled favourably in this case due to the fact that an undertaking and a waiver were required and made a condition of the ruling. Revenue officials knew the waiver was not enforceable. The side agreement is a contingent liability for future advance rulings because future taxpayers may demand the same arrangements based on precedent.

The real issue is the integrity and fairness of the tax system and, in this instance, department officials responsible for the final decision should be criticized for the following:

- 1) the lack of documentation or minutes of the final meeting of December 23, 1991, to bridge all the discussions and opinions that led to the final ruling;
- 2) the need for a side agreement to legitimize and/or qualify the asset in the trust as taxable Canadian property which in hindsight gives the appearance of retroactivity;
- 3) the failure to publish for the public the advance tax ruling in a timely fashion, and;
- 4) when it was published, the failure to mention that it had been made on condition that the taxpayer provide an undertaking and a waiver.

These factors are enough to raise concern that a special agreement between Revenue Canada and a taxpayer may allow department officials to inadvertently weaken the tax base and violate the basic principle that the right to tax or not to tax rests with Parliament.

In conclusion, we do not agree that the Auditor General's concerns have been fully addressed. The Government has clarified the legislation and removed the ambiguities through a Ways and Means Motion in the House of Commons, despite the Government's reluctance to examine what happened in 1991.

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Ultimately, we must thank the Auditor General for drawing this matter to Parliament's attention — otherwise this clarification of the treatment of taxable Canadian property leaving the country may never have happened.

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# Supplementary Opinion to the Report of the Standing Committee on Public Accounts

I fully concur in the Committee's report, and I would like to begin this supplementary opinion by congratulating the Minister of Finance on having taken the necessary steps to clarify the tax rules governing transfers of assets and property outside Canada.

It is important to note that the events (the advance ruling) that were the subject of review by the Auditor General occurred on and about <u>December 23, 1991</u>, when the previous government, the Conservative government, was in power.

I have frequently praised the quality of the Auditor General's work, and the report of the Committee underlines its excellence, but I think it is important to reiterate our congratulations.

Both the individual and the Office he represents deserve our respect and consideration as the elected represent of the people.

The integrity of our tax system is vitally important, and in that regard I must pay tribute to Revenue Canada's open approach. In its taxpayer information circular entitled "Revenue Canada — The Rulings Directorate Service", the Department says,

"The Office of the Auditor General of Canada regularly examines the Directorate's work including the advance rulings and technical interpretations that it issues."

The role of the Public Accounts Committee as I see it is, among other things, to give Canadian taxpayers the opportunity to have their elected representatives review the financial administration and management of the various government departments and agencies. The Committee is a forum where senior officials and managers have to account for their stewardship of public funds.

The matter we have dealt with here concerns taxation of capital gains when a taxpayer decides to leave Canada and live elsewhere.

In this case, the vehicle used to transfer assets was a family trust, but it could have been something else. It is not the vehicle we should focus on but the taxation of Canadian capital gains in the event of emigration.

The present case does however highlight two points that merit analysis in light of the ordinary taxpayer's perception:

- 1. The government has an obligation to continue to be open and transparent in all its dealings; in this regard I want to congratulate all my colleagues on the Public Accounts Committee.
- 2. The popular perception is that the gap between the richest and the poorest in our society must be reduced.

In the present case, the use of a family trust as the transfer vehicle tends to accentuate rather than minimize the gap, even though legally family trusts are open to anyone.

In conclusion, in addition to supporting the conclusions of the majority report, I hope that the government and the Department of Finance will put forward a genuine proposal for reform of Canada's tax system, both as it affects individuals, organizations and corporations and from a technical standpoint.

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Respectfully submitted,

Denis Paradis MP for Brome-Missisquoi and Vice Chair of the Public Accounts Committee Appendix C PAC Reports

## REPORTS TO THE HOUSE

## Monday, 10 February 1997

## The Standing Committee on Public Accounts has the honour to present its

#### **FOURTH REPORT**

Pursuant to Standing Order 108(3)(d), your Committee considered Chapter 11 of the Report of the Auditor General of May 1996 (Revenue Canada — Combatting Income Tax Avoidance). Two meetings were held on this subject with representatives of Revenue Canada and the Office of the Auditor General, on June 12 and November 6, 1996.

#### Introduction

For several years now, the Public Accounts Committee has taken a special interest in issues involving Revenue Canada. For one thing, the Department underwent a number of major changes with the implementation of the GST and administrative consolidation of the former Departments of Customs and Excise and Taxation. For another, it has had to make an extra effort to retain the public's confidence in the income tax and GST collection system. It has stepped up its efforts to combat the underground economy and it has tried to increase the effectiveness of existing programs.

The Committee recognizes that these changes have put a great deal of pressure on departmental resources. However, it is important that Revenue Canada make sure that these resources are directed in a way that reflects its new priorities. The Department has taken a number of steps to improve existing programs. Over the past few years it has frequently responded positively to observations made by the Auditor General in his audits. In the spring of 1995, the Committee began consideration of Revenue Canada's collection, audit and special investigations programs. During the Committee's meetings with them, departmental representatives said that the Department already had a strategy that it planned to implement the following year. The Committee said in the report it tabled on these issues that it supported the Department in this endeavour but that it intended to follow developments closely. It is in this perspective that the Public Accounts Committee decided to report on the Tax Avoidance Program.

#### **Background**

Through its various audit programs, Revenue Canada seeks to enhance compliance with the legislation it must apply. Tax avoidance occurs when an operation that generates a tax advantage is contrary to the object or spirit of the law. It differs from tax evasion in that it does not consist in deliberately concealing income or falsifying expenditures.

The Tax Avoidance Program was designed to discourage abusive tax avoidance practices. Its main activities involve detecting and examining suspected abusive tax avoidance schemes and developing policies and procedures to counter them. In 1995–96, 139 full-time equivalents (FTEs) were working for the Tax Avoidance Program, and this number will rise to 160 over the next few years. Again in 1995–96, this group of auditors generated approximately \$365 million in reassessments, and Revenue Canada expects the amount generated to climb to \$500 million over the next few years.

These figures speak for themselves. Obviously the Public Accounts Committee has no desire to question the value of the Tax Avoidance Program. However, it must be ensured that the auditors who work for it have tools that function adequately. Tax legislation is the first tool they use in making reassessments. Another essential tool is cooperation with other parties involved in tax avoidance matters: this may entail cooperation with other sectors

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within the Department (Large Business or Appeals, for example) or with other departments (Finance or Justice, for example). The Committee believes that improvements could be made to the Program that would increase the effectiveness of these tools.

#### **Cooperation and Communication**

Until recently, when a tax avoidance auditor began to investigate a given file it was because a front-line tax auditor had decided to refer that file to him or her. In practice, few cases were referred to the tax avoidance auditors. The figures indicate that tax auditors of large businesses referred only 27 cases to the Tax Avoidance Division in 1994–95, and only one to the Toronto office. Moreover, referral practices are not necessarily uniform among the various district offices, which does not promote fairness. The Committee is not confident that a file would be handled the same way everywhere in Canada. At the meeting of November 6, 1996, the Assistant Deputy Minister, Mr. Barry Lacombe, said that he had not been very happy with the handling of the one Toronto tax avoidance referral. He considers, however, that the problem is unlikely to arise again given the new approach to large business audits: tax avoidance auditors will be an integral part of the large business audit team. The Committee regards this as a step in the right direction, facilitating cooperation between the large business tax auditors and the tax avoidance auditors. However, the Committee considers that it remains to be seen whether the new approach will be successful. The Committee has not been given many details on the way in which the expertise of the tax avoidance specialists will be used. It would also like to know how the new approach will encourage standardized case handling by different district offices. Accordingly your Committee recommends:

That, as soon as data are available for the 1996–97 fiscal year, the Department produce a report on the new approach incorporating tax avoidance auditors into large business tax audit teams. The report should compare the number of referrals made by each district office in 1996–97 with the number made in preceding years. The report should also show how the new approach has succeeded in encouraging standardized application of the rules governing large business tax audits.

The Committee also noted that the tax avoidance specialists were not getting enough feedback about changes by other sections to reassessments they had made. For example, assessments can be the subject of a notice of objection, and notices of objection are handled by the Department's Appeals Branch. According to the Auditor General, when assessments are changed the results of the procedure are not always communicated to the people who had worked on the file previously. The Committee considers that it would be helpful for tax avoidance auditors to be informed of the reasons for a change, so that they can be better prepared to identify situations that may lead to an appeal.

The Committee also found that there was a lack of communication regarding rulings handed down by the interdepartmental committee that reviews and approves every application of the General Anti-Avoidance Rule. Like the Appeals Branch, the interdepartmental committee does not systematically give the specialists the feedback they need on its rulings. During the meeting, Mr. Lacombe attempted to reassure the Public Accounts Committee about the problem of communication, noting a number of initiatives that had been implemented. For instance, Revenue Canada now issues a quarterly report to its tax avoidance auditors on all Interdepartmental Committee activities. Measures have been taken to ensure that anything that happens at the Appeals level is fed back to the auditors as well. Mr. Lacombe also said that Revenue Canada had set up a task force on communications. The Department is now working to implement the recommendations made by the task force. It should be noted that the Deputy Auditor General, Mr. Minto, said he was very encouraged by the Department's efforts. The Committee shares his positive reaction, but it still wishes to follow closely the Department's efforts in the area of communication. Accordingly your Committee recommends:

That, as soon as the data become available for the 1996–97 fiscal year, the Department produce a report on the initiatives it announced with respect to communication among its various sections. The report should indicate the extent to which the recommendations of the task force on communications have been implemented.

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## **Legislative Changes**

#### A. Abusive Tax Shelters

The legislation permits a taxpayer to deduct the losses arising from a tax shelter up to the amount invested or at risk. An abusive tax shelter is one that is set up so that taxpayers can deduct losses that exceed the amount at risk, or overvalue the underlying asset. The Committee found that, until very recently, abusive tax shelters have been the rule rather than the exception: of some 325 tax shelters audited between 1993 and 1995, Revenue Canada found that most were abusive.

Revenue Canada has taken steps to uncover such abuses and deal with them. For example, new rules have been adopted governing at-risk amounts, so that taxpayers cannot deduct losses worth more than the amounts they have put at risk by their investments. The Department has also introduced a new system of film tax credits. The Committee applauds these initiatives, but wonders whether the Department could not go further. During the meeting of November 6, 1996, the Committee asked the departmental representatives what Revenue Canada's reaction would be to the Auditor General's idea of imposing penalties on promoters of abusive tax shelters. In his report, the Auditor General commented that promoters of abusive tax shelters run almost no risks in Canada, whereas in the United States they can be charged and statutory penalties imposed.

The Committee was glad to learn that Mr. Lacombe supports the Auditor General's recommendation, which he regards as a necessary measure. Mr. Lacombe said that Revenue Canada was at that time discussing the possibility with the Department of Finance. However, he could not give a precise date when the discussions would conclude. The Committee considers that this matter should be a priority for the Department, and that it should act in consequence. Accordingly your Committee recommends:

That Revenue Canada and the Department of Finance take prompt steps to introduce penalties for promoters of abusive tax shelters.

#### B. Hardship Waivers

Another point raised by the Committee was that of hardship waivers in cases of abusive tax shelters. Revenue Canada can reduce the at-source deductions of taxpayers who have invested in tax shelters if they can prove that the deductions exceed the income tax payable at year-end. People buying into tax shelters are encouraged by the promoters to request a hardship waiver because it then becomes possible to finance the cash portion of the purchase out of the reduction in at-source deductions.

A request for a hardship waiver will be rejected only if the shelter is being audited at the time. Given that the Department's records show that most tax shelters have been found to be abusive, the Committee wonders whether the procedure for granting hardship waivers should not be rethought. The Committee understands the idea behind the waivers, but it considers that the limits on granting them are imprecise, especially where tax shelters are involved. Mr. Lacombe said that the Department was going to look into at-source deductions and propose changes if these were to prove necessary. The Committee considers that the Department could go further. Accordingly your Committee recommends:

That Revenue Canada initiate without delay an examination of the issue of at-source deductions, so that the Department will be in a position to inform the Committee, in its overall response to this Report, of any changes it proposes to make.

#### Interest Waivers

Since 1991, Revenue Canada has had discretionary power to waive or cancel all or part of interest and penalties assessed for the 1985 and subsequent tax years. During its consideration of the chapter on income tax debt

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collection in February 1995, the Committee was concerned about the fact that the Department could not determine the total value of reassessments made since 1991 under the Fairness Package. The amount of interest waived under the Fairness Package was nowhere apparent. In its response to the Committee's Eighth Report (1st Session), the Department said it would be presenting a report giving the cumulative total of interest and penalties forgiven under the Fairness Package, as well as a breakdown by reason for the waiver. The official publication of these data in the Public Accounts of Canada is scheduled to begin in 1996–97.

The Committee wants to make sure that the Department includes all relevant data in its report. The Committee learned that the new on-line system to identify cumulative interest can only indicate the amount of interest that has been cancelled by the Appeals Branch, and not the amount waived when a file is subject to audit. The Committee considers it important to know the real amount the Department is foregoing. Mr. Lacombe told the Committee that changes would be made to the system so that it can also produce figures for waived interest that does not appear in the accounting record. He thought the system for handling interest that has been waived should be in place in a year's time. He also said that cancelled and waived interest would be included in the Department's performance report to Parliament. Accordingly your Committee recommends:

That Revenue Canada step up its efforts to make the necessary changes to its systems, so that both cancelled interest and interest not appearing in the accounting record can be included in the Department's next performance report, in the autumn of 1997.

#### The Underground Economy

Although the issue of the underground economy was not specifically dealt with by the Auditor General in this chapter, the Committee would like to comment on it. First, the Committee considers that intense vigilance is required in dealing with the underground economy, because the battle is far from won. If underground transactions are not firmly opposed, they may undermine voluntary compliance. The Committee considers that the Department should continue its efforts to publicize fraud convictions widely. The Department should also try to improve its detection techniques still further, since taxpayers are finding more and more subtle ways of getting around the law. Second, the Committee shares the widely-held sentiment that the more complicated a tax is, the less willing people are to pay it. That is why the Committee urges Revenue Canada look actively for ways to simplify the administration of the tax legislation.

The Committee observed that the Department has made the fight against the underground economy one of its priorities, as evidenced by the fact that the resources assigned to this program will go from 1,200 FTEs to 2,000 FTEs by 1998–99. The Department estimates that this initiative will bring in net revenues of about \$100 million a year. The Committee does not question the decision to assign additional resources to the program, but it would like the initiative to be reviewed from time to time to ensure that these resources would not be more valuable elsewhere. The Committee is eager to see the conclusions arising out of the evaluation of the underground economy program that the Department is carrying out in 1996–97.

Pursuant to Standing Order 109, your Committee requests the government to table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (Issues nos.1, 2 and 3 which includes this Report) is tabled.

Respectfully submitted.

Michel Guimond

Chair

## REPORTS TO THE HOUSE

## Monday, 7 April 1997

# The Standing Committee on Public Accounts has the honour to present its

#### FIFTH REPORT

Pursuant to Standing Order 108(3)(*d*), your Committee considered Chapter 14 of the Report of the Auditor General of September 1996 (Service Quality). One meeting was held on this subject with representatives of Treasury Board Secretariat, Human Resources Development Canada, and the Office of the Auditor General, on 5 November 1996.

#### Introduction

Canadians pay for and receive a wide variety of services from their federal government. These services include issuing passports, answering tax inquiries, and processing claims for employment insurance. The audit reported in chapter 14 of the Auditor General's September 1996 Report examined 13 important services that are delivered directly to the public.

It is of great importance that services delivered by government be of the highest possible quality. These services often correspond to very fundamental needs, especially when they concern social security. In addition, for many, the process of receiving a service is the principal form of contact between them and their federal government. It is through this experience that they form their views of government as an institution. The quality of the service they receive is, therefore, an important determining factor in shaping opinions about government as a whole. In this respect, concern about the quality of this service goes beyond issues of great importance to individuals and touches upon confidence in our governing institutions. For all of these reasons, the quality of the services being delivered is an issue that should rank among the leading priorities of public servants and elected representatives alike.

In order to explore the quality of services delivered directly to Canadians by the federal government, the Committee met with Assistant Auditor General Maria Barrados, Secretary of Treasury Board Secretariat Peter Harder, and Mr. Hy Braiter and Mr. David Good of the Department of Human Resources Development on 5 November 1996.

#### Service Standards

One of the most effective ways to improve the quality of services is through implementation of service standards for such factors as timeliness, accessibility, reliability and accuracy of service. These standards — if developed in consultation with clients and public service providers — promise not only to improve services, but to enhance accountability and transparency. The performance of those providing services can be assessed against these standards and recipients will know what they can reasonably expect. Furthermore, the process of developing standards in consultation with recipients should help government assign priorities to the services it provides. This in turn should facilitate elimination of services for which there is little need or demand. Services that are retained can then be better targeted to address actual needs. From this perspective, developing and implementing service standards should be viewed as an integral part of the strategy to control costs and get government right.

The need for service standards is recognized within government. Unfortunately this need has not yet been fully realized.

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Beginning in December 1990, government has made repeated commitments to establishing clear standards for the services it delivers. Often, these commitments have included setting target dates for full implementation of these standards. One of the more recent expressions of this commitment is found in Part I of the Estimates for 1995–96 and states that "departments will have service standards in place for their major services by the end of 1996."

The Committee discovered that these expectations have not been met. In his Report the Auditor General indicates that, as of 31 March 1996, "none of the 13 services [audited] had published service standards that contained all of the required elements." (14.29) Based on this, as well as other, observations, the Auditor General concludes that "government expectations have not been realized" with regard to the implementation of service standards. Between completion of the audit, the release of its findings in September, and the Committee's meeting with witnesses on 5 November 1996, little had changed. As Maria Barrados, Assistant Auditor General, told us in her opening statement, "[o]verall, the government's progress in implementing service standards has been slow and its achievement uneven. Implementation target dates have not been met." (30:2)

During our discussion with witnesses, we endeavoured to find out why these expectations and commitments have not been met. Mr. Harder, Secretary of the Treasury Board and Comptroller General of Canada, told us that quality service "is a complex process" that "often takes five to seven years to accomplish." (30:4) The responsibility for implementing service standards and the quality services initiative, he emphasized, "lies with departments." (30:3) At another point in his testimony, he suggested that Parliament assume some of the responsibility, indicating that members of the Committee and "your colleagues in other committees would be very helpful ... if you asked where these various departments are on service standards, where their quality service plans are." (30:16) For his part, Mr. Braiter, of Human Resources Development Canada, agreed that it takes a long time to implement service standards, and stated that the biggest constraint involved was an attitudinal one — "making sure everybody really believes that the reason they are civil servants and public servants is to serve the public." (30:20) Mr. Braiter also stated that leadership was something "which we have lots of." (30:20). Yet, despite the claim of plentiful leadership and the passage of seven years — the outer limit identified by Mr. Harder as the amount of time needed to complete such exercises — the Auditor General reports that the results are incomplete and disappointing.

When the federal government first embarked on the Service Standards Initiative in 1990 (now part of the Quality Services Initiative), the President of Treasury Board was given the overall responsibility for the initiative. At least initially, the Secretary of Treasury Board "took a lead role in developing guidance, requesting progress reports and co-ordinating interdepartmental networks and committees" engaged in the service standards initiative. (14:22) Apparently, all of this has changed. Now, it is the departments' responsibility alone — with prodding from parliamentary committees — to ensure that standards will be developed for the services they provide.

Mr. Harder was asked to follow the example set by his predecessors and indicate when he expected all departments to have service standards in place. The Committee sought an answer to this question for two fundamental reasons. A commitment to a completion date constitutes an essential element in the accountability framework needed to ensure successful implementation of this initiative. Setting this date would send a clear message to the departments emphasizing the priority which the government assigns to this issue and the expectations flowing from that priority. Furthermore, by identifying a date, the Secretary of Treasury Board would confirm his department's leadership role in providing an implementation and accountability framework. Lastly, had he given a positive answer to the Committee's question, Mr. Harder would have given a commitment against which he and Treasury Board Secretariat could also have been held accountable.

Yet given this opportunity, Mr. Harder chose to tell the Committee:

I don't want to give a date so you or your successor can say, "You were here last week or last month and said the Government of Canada would be able to do it by x date," when in fact it has to be done by the departments that are delivering service changes. I don't think it would be helpful to have an artificial date. (30:33)

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Mr. Harder gave this answer in spite of his recognition that previous efforts to set implantation targets were "an attempt by the people who were leading this to provide an incentive and a level of encouragement to departments and signal the seriousness with which quality service is being focused on." (30:33) Apparently, this is an incentive he will not give, a signal that he will not send. In his opinion, the previous dates that were established, were "artificial." Mr. Harder's refusal to name a completion date was all the more surprising in light of his assertion that "many federal departments have introduced service standards" and are "now beginning to publish these standards." (30:3) If one accepts the accuracy of this statement, how difficult should it be to identify the point at which the exercise will be finished and standards in place for all departments?

Mr. Harder's comments appear to suggest that neither he nor Treasury Board Secretariat want to dictate to departments what they must do. But leadership also consists of other measures. It also consists of making clear statements of expectations and setting an example by accepting a measure of responsibility for outcomes that are achieved. What are departments to make of it when the Secretary of Treasury Board declines to do either one of these things? Clearly, if this initiative is not to be sidelined, as the Auditor General fears it might, Treasury Board Secretariat must accept its responsibility and move the process forward. To accomplish this, Treasury Board Secretariat must provide an implementation framework, must co-ordinate this effort throughout government and must offer departments the guidance and incentives for ensuring that they succeed. The Committee therefore recommends:

That Treasury Board Secretariat develop and make public its implementation framework for the Quality Services Initiative by 30 September 1997. Particular reference must be made to achieving service standards within the context of the Initiative.

Furthermore, we recommend:

That Treasury Board Secretariat lead the Quality Services Initiative by establishing, in co-operation with the departments, a final target completion date for the entire initiative, and by providing guidance and incentives to the departments to ensure that this initiative is completed successfully.

We also recommend:

That by 30 September 1997 Treasury Board Secretariat make public the target implementation date for the Quality Services Initiative.

Measuring performance against expectations is a key element in an accountability relationship. If departments are going to set standards for the services they provide, they must develop implementation plans that include target completion dates; otherwise, the process threatens to drag out forever. Once these plans and targets have been established, departments can be held accountable for achieving them.

It is important not to underestimate the difficulties involved in developing service standards and setting dates for implementing them. But although the exercise is difficult, it is not impossible. The Committee was pleased to note that Human Resources Development Canada — a department that is more heavily involved than most in delivering services to Canadians — showed no reluctance in naming the date by which it expected to have its service standards developed and published. Mr. Good told us that it is his department's "commitment and intent" to have the standards published by 1997–98, following consultation with its clients. If this department can take this step, others should be capable of doing the same. We therefore strongly recommend:

That all departments delivering services directly to Canadians establish plans for implementing the Quality Services Initiative. These plans must include a timetable for full implementation, including target dates for publication of service standards, and must be made available to Parliament and the public.

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In his report, the Auditor General stressed that in order to be effective, service standards should be developed in consultation with those receiving the services. While it would be unrealistic to expect that all client preferences will be met, they must be taken into account if a balance is to be achieved between what is needed and what can be provided. The Committee was thus troubled to learn that in those instances in which standards had been developed, little consultation with clients had taken place. This is of particular concern when departments adopt technological approaches to service delivery in order to save money. For example, reliance on touch-tone phone services may create substantial barriers for senior citizens, or for those who prefer to deal with human beings rather than machines. In addition, efforts to reduce costs by consolidating services in single locations may move these services beyond the reach of those who truly need them. These are drawbacks that might be avoided if careful consultations with clients had been conducted before hand. We therefore recommend:

That departments, as an integral part of establishing standards for the services they provide, consult those receiving services and take their needs into account before final implementation occurs.

Mr. Harder indicated that standing committees of the House of Commons have a role to play in ensuring that the quality services initiative succeeds. If Standing Committees are to do this, they must have appropriate information on departmental service standards. Recently, under the guidance of Treasury Board Secretariat, several departments and agencies have begun to produce pilot performance documents that have been tabled in the fall and referred to the appropriate standing committees. Apart from these pilot documents, departments regularly include statements regarding past performance in part III of their Estimates. In order to give departmental progress in setting and meeting service standards the profile it deserves, this information should be made available to Parliament through either one of these vehicles. Accordingly, we recommend:

That departments make public the standards they have established for the services they deliver to Canadians and report performance against these standards in either Part III of their Estimates, or, when appropriate, in performance reports tabled in the House of Commons in the fall.

In closing, we note Ms. Barrados' observation in her opening statement that "little information has been provided by Treasury Board Secretariat to Parliament to indicate clearly the progress in the implementation of service standards." (30:3) In order to rectify this shortcoming, we recommend:

That Treasury Board Secretariat report annually to Parliament on the progress being made in the development and implementation of service standards throughout government, either in Part III of its Estimates, in its performance report, or in a separate document designated for this purpose.

#### **Telephone Services**

Because the telephone has become the most common method used by Canadians to communicate with government, the Auditor General focused particular attention on the telephone operations of six of the 13 services that were examined. The results reported are not encouraging.

Despite variations, callers generally had difficulty in getting through to call centres. Callers often encounter busy signals or are put on hold; many abandon their attempt and hang up. When calls are answered, the accuracy of the information provided is sometimes in doubt. Most of the audited departments did not assess the quality of information being provided by their phone services. The one instance in which verification did take place, the results were particularly discouraging. The Committee was particularly dismayed to discover that according to the Auditor General, Revenue Canada's Taxation branch's rate of accuracy of answers "has varied between 61 and 79 percent in the last few years." (14.57) Since calls often involve efforts to obtain information about vital government services, long waits and inaccurate answers are simply not acceptable.

In response to these problems, actions taken by the departments involved seems scarcely adequate. Although some have established internal accessibility targets, none have published service standards that would give

clients an idea of how long they can reasonably be expected to wait for calls to be answered. The quality of telephone contacts is not regularly monitored and, with the exception of Taxation and Statistics Canada, none of the services had set targets for the accuracy of answers to their clients. Finally, little effort has been made to collect and analyse the nature of clients' calls and complaints.

In order to correct these deficiencies, the Committee recommends:

That departments with telephone services publish service standards governing accessibility and accuracy of answers, that they collect and analyse client complaints about telephone services, and that they regularly measure and publicly report performance against the standards they have established.

#### **Direct Deposit**

During our meeting with witnesses we discovered that many of the inquiries received by departmental telephone services concerned the status of cheques sent out to clients. One way of reducing these enquiries — and thus the burden placed on phone centres — would be to have more of these cheques deposited directly into recipients' bank accounts. Other benefits include reduced costs to government (in terms of postage, envelopes, handling, etc.) and enhanced security for senior recipients.

Considerable progress has already been achieved in enhancing the use of direct deposits. Public Works and Government Services Canada is leading a government-wide initiative to promote the use of direct deposit and the number of such deposits has grown from 5 million in 1991 to 74 million in 1995–96. The Committee learned that Old Age Security, the Canada Pension Plan and the Child Tax Benefit now have direct deposit enrolment rates of 63.8 percent, 60 percent and 48.2 percent respectively as of 31 March 1996.

The Committee recognizes that efforts to increase the numbers of direct deposits may encounter certain limitations. For example, our witnesses pointed out that some recipients are either transient, do not have permanent bank accounts, or both. However, while we acknowledge that the level of direct deposit can not be brought to 100 percent, we do think that departments must continue efforts to expand this practice to the fullest extent possible. The Committee therefore recommends:

That departments engaged in paying benefits continue with efforts to enhance the use of direct deposits as the principal means of payment.

#### Conclusion

As Members of the House of Commons Standing Committee on Public Accounts, we are concerned that government achieves maximum value in exchange for the moneys it receives through taxes and other fees paid by Canadians. We are also concerned that those who are entrusted with public funds be held accountable for their prudent use in accordance with policies adopted by Parliament.

As individual Members of the House of Commons, we are also deeply concerned with the well-being of our constituents. For us, the notion of providing good service to Canadians extends well beyond a simple theoretical issue. Instead, this is a matter that is of fundamental importance in the day-to-day lives of many of those whom we represent.

The results reported by the Auditor General in this chapter of the September 1996 report therefore deeply concern us at both levels. It is evident that since improvements to service delivery are not being pursued with sufficient rigour, opportunities to reduce costs while tailoring programs to meet actual needs are being lost. It is also evident — and we know this through daily contact with those whom we serve — that the needs of individual citizens are not being fully met. Neither situation is tolerable.

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We therefore call upon government to act promptly on both our recommendations and those made by the Auditor General of Canada. Through sustained effort and sufficient will, government should be able to provide Canadians with services that are of the highest quality possible in accordance with standards that are reasonable and public. In light of the taxes they pay and the need that exists, Canadians should not be required to wait any longer.

Pursuant to Standing Order 109, your Committee requests the government to table a comprehensive response to this Report.

The supplementary opinion of Denis Paradis is appended to this Report.

A copy of the relevant Minutes of Proceedings (Issues nos. 2 and 3 which includes this Report) is tabled.

Respectfully submitted,

Michel Guimond

Chair

## Denis Paradis MP Brome-Missisquoi Vice-Chairman of the Standing Committee on Public Accounts

## Supplementary Opinion to the Report of the Standing Committee on Public Accounts Wednesday, March 19th, 1997

#### **Direct Deposit**

#### For salary purposes

Direct deposit is an appropriate payment method for those who receive salaries from the federal government. The system is practical and economical for the stable, regular salaries paid by the government to its employees.

#### Prevention of fraud

However, for payments made under specific government programs, such as employment insurance and family allowances, the use of direct deposit is likely to require a degree of saintliness among recipients that is beyond the reach of the average citizen. If the money is deposited automatically and regularly in a recipient's bank account, the recipient may well not feel a sense of urgency about informing the payor that the conditions of his or her status or availability have changed, whether temporarily or permanently.

Conversely, payment by means of a cheque forces the recipient to take definite action (to endorse or deposit the cheque), and this may prevent cases of abuse or fraud.

For example, although our employment insurance system requires recipients to be available for work in Canada, it is relatively easy to go to Florida with the direct deposit system, while endorsing and depositing a cheque is likely to require a local presence.

#### The visibility of government

At a time when we are trying to develop a feeling of Canadian pride, one issue must be raised concerning the significance of government visibility when a payment is made to a recipient. Those receiving employment insurance benefits or a family allowance should receive a real cheque from the government rather than using the direct deposit system.

In conclusion, direct deposit has the effect of distancing citizens from their government.

Respectfully submitted,

Denis Paradis, MP Brome-Missisquoi

#### **REPORTS TO THE HOUSE**

#### Monday, 14 April 1997

#### The Standing Committee on Public Accounts has the honour to present its

#### **SIXTH REPORT**

Pursuant to Standing Order 108(3)(d), your Committee has studied Chapter 26 of the November 1996 Report of the Auditor General (Canada Infrastructure Works Program — Lessons Learned). The Committee held a meeting on this subject on February 20, 1997 with representatives of the Office of the Auditor General, the Canada Infrastructure Works Office, the Treasury Board Secretariat and the Federal Office of Regional Development (Quebec).

#### Introduction

The Canada Infrastructure Works Program was introduced by the federal government in 1994 as a temporary initiative, with a planned duration of five years. A series of federal-provincial agreements provides the framework for its implementation and assigns much of the authority for the day-to-day delivery to the provinces.

The cost of the program is shared. The federal government contributed approximately \$2 billion in program funds, with roughly a further \$4 billion provided by provincial governments and municipalities, along with other local sponsors. Federal funds were allocated to provinces, territories and First Nations based on their respective shares of population and unemployment, both of which were given equal weight.

The Auditor General's observations about the Canada Infrastructure Works Program are presented as lessons learned. The Committee is of the view that his observations come just at the right time, given the government's recent decision to extend the program. \$425 million will be added to the \$175 million expenditure that was planned for under the initial program. Along with the program evaluation conducted by Mr. Richard Soberman at the University of Toronto, published in September 1996, the Committee feels that the government now has two high-quality documents prepared by outside sources that will enable it to identify the program's strengths and weaknesses. At the meeting, the Committee's goal was in fact to find out what lessons the government had learned from the first phase of the program, and whether the government was planning to make changes in the second phase or in future programs of the same kind.

The Committee would also like to point out that the program has proven beneficial from a number of standpoints. First, the program was implemented rapidly, which was essential if its goal — that of accelerating national economic recovery by creating jobs — was to be achieved. Within a period of only eight weeks following the announcement of the program, the federal-provincial agreements were put in place, program frameworks were developed, guidelines established, and the program made operational. Second, existing expertise and competencies were considered, but all the stakeholders had some input. Program implementation focused on local identification of needs, community priority setting and local municipal decision-making about project selection. The projects selected were examined by the provinces and the federal government. Third, the 12,000 projects approved have contributed substantially to improved local infrastructures in Canada.

Early in the meeting, Mr. Paul Thibault, Executive Director of the Canada Infrastructure Works Program, told the Committee that he noted some discrepancy between the text of Chapter 26 which in total is rather positive about the program, and the Main Points and the Auditor General's press release, which both concentrate almost entirely on the negative. After reviewing these documents, the Committee acknowledges that Mr. Thibault's dissatisfaction with the press release may well be justified.

#### Compliance audit

The success of the Canada Infrastructure Works Program (CIWP) will likely encourage the government to explore this new method of delivering service. The Committee would like to make a few comments on this point. The federal government was not responsible for day-to-day CIWP project management, which was left to the provinces and municipalities. This arrangement had the effect of avoiding overlap of functions and reducing overall administrative expenditures. The Committee is in agreement with these terms. However, Committee members feel it is important not to lose sight of the fact that Parliament must be certain that public funds are spent on the purpose for which they are intended. It is therefore important to know that program goals have been reached and that the conditions were met.

Since one may assume that the other levels of government also want to be sure of this, the Committee believes that any level of government could actually carry out the compliance audit. The federal government would only have to ensure that the criteria used in conducting the audit are acceptable.

In his report, the Auditor General noted that the agreements contained no specific requirements for timely compliance audits. Quebec has been relatively more effective in this regard, and has introduced a compliance audit system for a sampling of projects. The audits were to be completed before final payments were made, and penalties were provided for.

In its response at the end of Chapter 26, the government agreed with the conclusion that the requirement for a compliance audit plan should have been included in each of the agreements at the outset. The Committee was pleased to learn that the CIWP Office will be negotiating agreements on audit planning for the extended program. Therefore, the Committee recommends:

That the CIWP Office follow Quebec's example when negotiating agreements with its partners in order to put in place a compliance audit system. The Office should also ensure that the quality and coverage of the compliance audits meet the federal government's requirements for the program.

#### Additional or incremental investment

One program requirement concerned the generation of additional or accelerated investment. In other words, it was expected that the investment in infrastructure would be greater than it would have been if the program had not existed. Government funds were not to be invested in projects that would have been carried out in any case. The Committee noted that incremental investment is not easy to measure. Two factors must be understood: how much actually was spent by municipalities on infrastructure, and how much would have been spent had the program not existed. Because there is no exact way to determine municipalities' prior intentions, the measure of the level of incrementality is at best approximate. As Mr. Thibault said at the meeting, this is not an exact science.

In the Committee's view, it is nevertheless important to determine the extent to which the program has made a difference, even if it is only possible to come up with an estimate. The CIWP evaluation conducted by Mr. Richard Soberman states that this was not a priority objective in the decision-making process: "In terms of Program weaknesses, one relates to the level of incremental spending. Employment and other economic benefits are directly related to incrementality but, except for Quebec, there appears to have been little serious effort to enforce this program requirement. Nation-wide, the level of incrementality cannot be determined with a high degree of certainty." However, the study uses two assumed levels of incrementality for its economic evaluation — 100 per cent and 60 per cent. The author mentions that the level of 60 per cent appears to be more realistic than the level of 100 per cent.

For his part, the Auditor General estimated that, in 1994, 35 per cent of total expenditures replaced capital expenditures that would have been incurred in any case. The Auditor General, then, calculated the level of

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incrementality at 65 per cent. In its response at the end of the Chapter, the government stated that recent information from Statistics Canada on actual municipal capital investment supports the government's analysis of a level of additional investment that was somewhat higher than the chapter's estimates.

Faced with all these data, the Committee would like to make two observations. First, the Committee notes that the projects that did not generate incremental investment were probably not any less useful or necessary on that account. Clearly, almost all the projects resulted in local infrastructure enhancements and created jobs. However, the Committee is of the view that that the government must attempt to maximize the returns made on investments in this type of program. The Committee does not want to get into a war of numbers on what the program's real level of incremental investment was, what it would have been otherwise, and what it should be now that the program has been extended. However, and this is the Committee's second observation, efforts should be made to demonstrate more clearly that there is incremental investment.

In this regard, the Committee would like to highlight the innovative aspect of the approach used in the Canada-Quebec agreement to ensure incremental investment. The Ministry of Municipal Affairs calculated the minimum capital expenditure level for every municipality in Quebec. Mr. Guy MacKenzie, Assistant Deputy Minister in the Federal Office of Regional Development (Quebec), told the Committee that the minimum capital expenditure level was determined by taking the lowest result from the following three calculations: average capital expenditures for engineering in 1991 and 1992, and the average for municipalities of comparable size.

The Committee would like to mention that in his 1995–1996 report the Auditor General for Quebec mentioned a few points that raise concerns about the calculation of the minimum level. The method used can be improved, but the Committee believes that the basic idea is a good one. In the other provinces, most provisions for additional investment were applied to individual projects rather than to overall investment by municipalities. This situation can be problematic. For example, a new, improved project may hide a project abandoned because it would have been ineligible for CIWP assistance. If projects are simply replaced, overall investment by municipalities is not necessarily increased.

During the meeting, the Committee asked Mr. Thibault whether he planned to monitor the level of incremental investment more closely. Mr. Thibault answered in the affirmative. He went on to say: "... we now have an evaluation plan which we will implement for the first part of the program in an effort to deal with these questions in a better fashion and to provide you with more details the next time."

The Committee is aware that calculating incremental investment on the basis of a minimum level will constitute a significant alteration in the agreements. We are therefore not expecting that it will be included in the current negotiations for the extended program. However, the Committee recommends:

That this component be taken into consideration in any similar infrastructure program in the future.

Pursuant to Standing Order 109, the Committee requests the Government to table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (Issue No. 3 which includes this Report) is tabled.

Respectfully submitted,

Michel Guimond

Chair

#### REPORTS TO THE HOUSE

#### Tuesday, 15 April 1997

#### The Standing Committee on Public Accounts has the honour to present its

#### **SEVENTH REPORT**

Pursuant to Standing Order 108(3)(*d*), your Committee has studied Chapter 23 of the November 1996 Report of the Auditor General (Materiel Management in the Federal Government).

#### I. INTRODUCTION

In the government of Canada, the term "materiel" refers to all moveable public property and all other assets other than money and real property. Costs associated with these assets are significant. Each year, federal government materiel purchases are quite large — for fiscal year 1994–95, for example, approximately \$8 billion was spent for this purpose. In addition, the estimated value of the government's materiel holdings is considerable — approximately \$50 billion dollars. Of these holdings, materiel valued at between \$8 and \$10 billion is kept in warehouses, at an estimated carrying cost of between \$2 billion and \$2.5 billion annually.

In light of these costs, it is important that management of materiel assets — an activity which encompasses acquisition, use, and disposal — be conducted as effectively and efficiently as possible. In chapter 23 his Annual Report for 1996, however, the Auditor General of Canada informed Parliament that many of the deficiencies in the government's materiel management practices identified in audits as far back as 1980 still exist. Although he reported that initiatives are under way to correct these deficiencies, he indicated that additional actions are required in order to ensure that they succeed.

As a consequence of the costs involved and the need to ensure that immediate steps are taken to produce more effective management of these assets, the Committee met with the Auditor General of Canada, Mr. Al Clayton, Executive Director, Bureau of Real Property and Materiel, Government Operations Sector, Treasury Board Secretariat, and Ms Louise Fréchette, Deputy Minister, Department of National Defence, on 11 and 12 February 1997.

#### II. OBSERVATIONS AND RECOMMENDATIONS

From the information contained in the Auditor General's Report and testimony given by witnesses, the Committee learned that materiel management within the federal government constitutes a significant challenge. The audit report found that the departments and agencies examined often do not know how much materiel they hold in inventory, and where it is located. Roles and accountability relationships are unclear, and information systems established to track materiel holdings are quite often inadequate; this makes good materiel management very difficult.

#### The Policy and Management Framework for Materiel

A sound policy and management framework needs to be in place so that materiel holdings can be managed effectively and with due regard for economy. The Auditor General's findings indicate that although these basic structural elements are in place, they contain gaps which frustrate better management of these costly resources. Improvements are needed with respect to the role of Treasury Board Secretariat — the central agency responsible for monitoring materiel management practices throughout government — and at the departmental level where the principal responsibility for the day-to-day management of materiel resources lies.

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The responsibility for providing leadership, direction and advice to departments on materiel management belongs to Treasury Board Secretariat. The Auditor General reports that the Secretariat has taken a number of initiatives to fulfil its role in this respect; an important aspect of this role, however, is not receiving the attention it deserves. According to its own policies on materiel management, Treasury Board Secretariat monitors — the implementation and effectiveness of Treasury Board's materiel management policy. The audit reported, however, that the Bureau of Real Property and Materiel, the unit within the Secretariat that deals with materiel policy,

has access to departmental internal audit and program evaluation reports but does not monitor them systematically to identify problems with the materiel management policy or its implementation. (23.27)

According to the Auditor General, Treasury Board Secretariat officials explained that this systematic monitoring of departmental internal audits and program evaluations is not carried out

because the departmental reports do not provide information that [Secretariat officials] consider useful to address systemic issues...(23.27)

This assessment was confirmed by Mr. Clayton, Director of the Bureau of Real Property and Materiel, who told the Committee that departmental information systems "are not all that good." (39:16) In his Report, the Auditor General concluded that Treasury Board Secretariat does not have all the information it needs to fulfil its responsibilities.

To further complicate matters, there appear to be different interpretations of what Treasury Board Secretariat's role is or ought to be with respect to monitoring materiel management throughout government. While these interpretations may have varying degrees of accuracy and validity, they need to be resolved as part of the effort to improve government-wide materiel management. As things currently stand, the uncertainty surrounding Treasury Board Secretariat's role prompted some members of the Committee to wonder whether the Secretariat's involvement in materiel management was really needed. Others felt that perhaps the Secretariat should fulfil its mandate as described in its policies on a more proactive basis.

Two steps are needed to address problems in the policy and management framework for materiel management. Treasury Board Secretariat needs to clarify its role in this area — including its monitoring function — and to better align practice with policy. For their part, departments also need to clarify roles and responsibilities, and to put in place information systems that respond to Treasury Board Secretariat's needs as well as their own. Accordingly, as a first step, we recommend:

That Treasury Board Secretariat review and clarify its role in government-wide materiel management, including the monitoring of departmental materiel management performance, and that it subsequently align its materiel management practices with policies.

Clarification and affirmation of the Secretariat's role should be accomplished in a timely fashion so that departments can align their materiel practices with policies accordingly. We therefore recommend:

That Treasury Board Secretariat complete its review and report the results no later than 30 September 1997.

Once Treasury Board Secretariat has determined what its role should be, departments will have to develop systems capable of providing the kind of information on material management that the Secretariat needs to perform this role. These information systems must also be able to give departmental managers the data they need to assess performance and make informed judgements regarding material resources. The Auditor General stressed the need for such systems in his Report, observing that he had "found deficiencies in all the organizations" material management

information systems." (23.36) Often, information could not be transferred from one system to another within departments and the data they contained was incomplete. As a result of these deficiencies, the actual costs of using and holding materiel were not fully known, and sound decisions regarding the procurement, use, and disposal of materiel could not be taken. Another consequence is that government departments may be holding inventories surplus to their needs; indeed the evidence reported by the Auditor General suggests that this is the case. Since departments cannot properly manage what they cannot count, we recommend:

That departments develop integrated information systems capable of providing their managers and Treasury Board Secretariat with data on materiel management practices and performance that is both timely and relevant. This information should include data on materiel inventories and holding costs.

The Committee also noted with some concern that Treasury Board policies that direct departments to make the costs associated with the use of materiel known to end users are not always adhered to. This is a situation that must be corrected promptly in order to encourage the prudent and economical use of resources. We therefore recommend:

That Treasury Board Secretariat and the departments take immediate steps to ensure that the costs associated with the use of materiel be made visible to end users.

The Committee understands that among the departments examined for the audit of materiel management, there are already major efforts underway to revise and simplify policies and to clearly define roles, responsibilities and accountability for materiel management. These steps are welcome and departments should make every effort to ensure they succeed. Establishing timetables and reporting on the status of these initiatives will help enable them to do so. The Committee therefore recommends:

That departments provide status reports and timetables on their initiatives under way to address long-standing material management deficiencies in Part III of their annual Estimates, beginning with fiscal year 1998–99.

The Committee considers that better materiel management is vital. We believe, therefore, that Treasury Board Secretariat should also report regularly to Parliament on the overall status of materiel management in the federal government. These reports should focus on the Secretariat's role in this area, discuss improvements that have been made and concrete results produced. We therefore recommend:

That Treasury Board Secretariat report annually to Parliament on the status of materiel management in the federal government. In particular, such reports should include references to the status of accountability relationships, costs associated with holding materiel, details regarding initiatives to reduces these costs, and explicit statements of the amounts saved as a consequence. Such reports should also draw Parliament's attention to those departments that have made real progress and those departments whose progress has fallen short of expectations.

#### **Disposal of Surplus Materiel Assets**

When materiel assets cease to be of use to departments, there are mechanisms in place to facilitate their disposal. Disposal of materiel is a means by which departments can reduce surplus inventories and also represents a source of potential income: the Auditor General reports that revenues from the disposal of surplus materiel are in excess of \$40 million a year. In addition, a study by Treasury Board Secretariat in 1995 reported that the potential annual cost savings from eliminating unnecessary inventory could reach \$1.25 billion. Although inventories may have been reduced since that time, the Auditor General indicates that the potential for significant savings still exists.

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It therefore stands to reason that the disposal process should function smoothly and that departments should have all reasonable access to it. The Committee learned, however, that there is some confusion about the way this process should operate.

Under current policy, the Crown Assets Distribution Directorate (a unit of Public Works and Government Services Canada) is required to provide common services for the disposals of assets. In 1992, legislative changes were made to allow departments the option of using these services or taking care of disposals themselves. Following this change, some departmental disposal projects were set up on a pilot basis. Although some encouraging results were obtained, no decision has yet been made on the balance required between departmental initiative and the need for some central control and co-ordination of this activity. The Auditor General told the Committee that this issue is currently under study but that it should be resolved as soon as possible in order to take full advantage of the disposal option. Mr. Clayton assured the Committee that the results of the study should be released within days or months. The Committee looks forward to the conclusions and wishes to encourage their timely presentation. We therefore recommend:

That Treasury Board Secretariat and Public Works and Government Services Canada make the conclusions of their study of disposal mechanisms known by 30 September 1997 at the latest.

#### The Department of National Defence

Of the departments included in the audit, the Department of National Defence spent the most on materiel acquisition: \$4.2 billion during the 1994–95 fiscal year. The value of its materiel inventory was also quite considerable; the Department's own estimates indicated that these holdings had a value of approximately \$8.5 billion and a direct annual inventory management cost of \$567 million.

Because of the size of its materiel holdings and the scope of its efforts to introduce changes to the way it manages them, the Committee was anxious to hear from the Department on the progress it is making in this area; if such a large and complex organization can solve its problems in materiel management, this should serve as a source of information and encouragement to other departments and agencies.

The Committee learned that the Department has initiated a Cost-Visibility Project to supply its managers with better information on costs. Furthermore, unlike the other audited organizations, DND has a comprehensive, department-wide, asset and inventory management system. This system is not capable, however, of providing adequate aggregate information and is being upgraded. The Department has also identified material inventory surplus to its needs and is taking steps to reduce the excess. Ms Fréchette told the Committee that the Department has an overall objective to reduce its stocks of inventory by at least 30% over the next three years.

The Committee was encouraged that the Department is taking steps to correct problems in its management of materiel, and is anxious that these efforts remain on schedule and produce the expected results. We therefore recommend:

That the Department of National Defence establish a firm timetable for completion of its initiatives to renew its material management practices by 30 September 1997, and report its progress in Part III of its Estimates, beginning with fiscal year 1998–99.

The Committee is also concerned about the status of the Department's project to upgrade its supply system. According to the Auditor General, restructuring of materiel management in the Department depends to a great extent on successful completion of this project. He reports, however, that the project is at risk. (Exhibit 23.5) Ms. Fréchette, on the other hand, told the Committee that the Department has since modified its approach to the project and that the renewed system "will be delivered on time and within budget." (39:9) The Committee was gratified to receive these assurances.

#### III. CONCLUSION

The procurement and use of materiel is one of the federal government's costlier activities. It is therefore of vital importance that this activity be properly managed in order to keep costs to government and the taxpayers who fund it to a minimum. At the same time, these resources have to be intelligently managed in order to ensure that they deliver maximum value.

Based on its review of the Auditor General's audit of materiel management practices in four departments and agencies and the role of Treasury Board Secretariat in this area, and on meetings with witnesses, the Committee is encouraged by progress that has been made. To ensure that the initiatives that are under way produce the desired results the Committee believes that certain key steps must be taken. In particular, Treasury Board Secretariat must define its mandate clearly with regard to materiel management, accountability relations must be clarified, departments must develop systems that can record the right information on materiel use and holdings, and an appropriate disposal regime must be established quickly. The Committee firmly expects that its recommendations, combined with those made by the Auditor General, will help to ensure that public resources consumed by this aspect of what the federal government does will not be wasted.

Pursuant to Standing Order 109, the Committee requests the Government to table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (Issue No. 3 which includes this Report) is tabled.

Respectfully submitted,

Michel Guimond

Chair

#### **REPORTS TO THE HOUSE**

#### Thursday, 17 April 1997

#### The Standing Committee on Public Accounts has the honour to present its

#### **EIGHTH REPORT**

In accordance with its Order of Reference of Thursday, February 20, 1997, your Committee has considered Vote 30 under FINANCE in the Main Estimates for the fiscal year ending March 31, 1998 and reports the same.

A copy of the relevant Minutes of Proceedings (Issue No. 3 which includes this Report) is tabled.

Respectfully submitted,

Michel Guimond

Chair

#### REPORTS TO THE HOUSE

#### Wednesday, 23 April 1997

#### The Standing Committee on Public Accounts has the honour to present its

#### **NINTH REPORT**

Pursuant to Standing Order 108(3)(d), the Committee considered Chapter 17 of the September 1996 Report of the Auditor General of Canada (Human Resources Development Canada — Canada Pension Plan: Disability). The Committee held one meeting on this subject, on December 12, 1996, with representatives of the Office of the Auditor General and Human Resources Development Canada (HRDC).

As its name indicates, Canada Pension Plan: Disability (CPPD) is a component of the Canada Pension Plan (CPP), itself a component of Income Security Programs. CPPD benefits represent approximately \$3 billion, or 18% of total CPP payments. Since 1995, HRDC has been regionalizing its operations. CPPD operations now come under the responsibility of the Regional Branches, which report to the Deputy Minister (DM) on all departmental activities in their respective regions.

Eligibility for CPPD benefits is conditional: beneficiaries must (1) be between 18 and 65 years of age; (2) have contributed to the CPP for at least two of the last three years or five of the last 10 years before the date of the disability; (3) have been declared disabled according to the definition adopted by the CPP; and (4) apply in writing on the prescribed form. In 1996, disability benefits varied from \$326 to \$871 per month. Under certain conditions, beneficiaries may also be eligible for benefits for dependent children.

The number of CPPD beneficiaries rose from 155,000 in 1986–87 to nearly 300,000 in 1995–96, an increase of 93% and a compound annual rate of growth of 6.8%. In comparison, the labour force increased at a compound annual rate of growth of 1.1%. This phenomenon is not unique to Canada and has been observed in a number of other industrialized countries. Private-sector organizations working in the field of disability insurance have also seen a significant increase in the number of their clients.

Given this significant increase in costs, some observers may be led to believe that cost reduction necessarily means stricter eligibility criteria. The Committee wants to make it quite clear from the outset that it does not share that opinion. The Committee agrees with the Auditor General (AG) that it is possible to reduce CPPD costs considerably, through additional efforts to improve its management, without causing any prejudice to applicants who meet the eligibility criteria. At the meeting, the Committee noted that there were a number of areas where improvements to CPPD management could be made.

The Committee wants to emphasize that, at the meeting, HRDC DM Mel Cappe stated that HRDC agreed with most of the AG's recommendations. He added that HRDC was well aware that CPPD costs were rising and that the public was losing faith in CPPD's long-term viability. He noted that HRDC had taken measures in order to solve this problem. However, he added:

Even with our initiatives to date, our department recognizes and accepts the challenge to improve certain aspects of the management of the program. In fact, we have appointed a senior departmental manager to head a special project [...]. It will coordinate and monitor the implementation of the measures already in progress, as well as new initiatives to address the Auditor General's recommendations (37:4).

HRDC also submitted to the Committee an action plan with eight priorities. The action plan notes present and future measures by HRDC in response to the AG's observations. Over half these measures are to be

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implemented by March 1997, and nearly all by March 1998. The DM made a commitment to provide the Committee with interim reports on its action plan in April 1997 and April 1998.

The Committee is of the opinion that the action plan clearly shows HRDC's will to manage CPPD better, and encourages HRDC to pursue its efforts to this end. However, the Committee believes that implementing the action plan cannot solve all HRDC's management problems. As the AG summarized the situation at the meeting:

An action plan cannot change the culture of an organization on its own. To successfully implement the changes that are required, management of the department and of CPP must show leadership by setting out the general policy direction they intend to follow with disability. This would require such measures as, first, demonstrating determination and continuity with respect to corrective measures that need to be implemented even in a context of rapid change; second, deciding whether proactive management is required with respect to this very large caseload; third, redoubling efforts to obtain closer cooperation among interested stakeholders; and finally, encouraging staff to be attentive to the better management practices of other plans (37:2).

It is clear to the Committee that better CPPD management does not mean a witch hunt for abusers of the system. It is of the utmost importance that program managers remain understanding at all stages of the process. Nevertheless, the persons receiving benefits under the program will be the main ones to benefit from improvements to it: faster application processing and less paperwork will ensure easier access.

In this respect the Committee recommends the following:

That, in developing an official quality control program, HRDC develop performance indicators to determine whether HRDC is achieving the program's objectives. HRDC is to inform the Committee of these indicators in the April 1998 interim report on its action plan;

That HRDC increase the exchange of information with workers' compensation boards, provincial social service departments, and private insurance companies with the view of increasing the efficiency of the program; and

That HRDC evaluate the possibility of making greater rehabilitation efforts in order to allow more beneficiaries to benefit from the rehabilitation program.

Pursuant to Standing Order 109, the Committee requests the government to present a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (Issue 3 which includes this Report) is tabled.

Respectfully submitted,

Michel Guimond

Chair



#### APPENDIX D

### REPORT ON THE AUDIT OF THE PRESIDENT OF THE TREASURY BOARD'S REPORT TO PARLIAMENT:

## TABLINGS IN PARLIAMENT FOR PARENT CROWN CORPORATIONS: ANNUAL REPORTS AND SUMMARIES OF CORPORATE PLANS AND BUDGETS

The Financial Administration Act requires the President of the Treasury Board to lay before each House of Parliament a report concerning the timing of tabling, by appropriate ministers, of annual reports and summaries of corporate plans and budgets of Crown corporations subject to the reporting provisions of Part X of the Act.

The report on these tablings allows Parliament to hold the appropriate ministers (and, ultimately, the Crown corporations) accountable for providing, within the relevant statutory deadlines, the information required under the *Financial Administration Act*. Accordingly, the report is required to indicate the time at, before, or within which the annual reports and the summaries of corporate plans, capital budgets and operating budgets (and amendments to them) were required to be tabled before each House during the reporting period; and the time they were actually tabled. The report on tablings is the responsibility of the President of the Treasury Board and is included in his annual report to Parliament, *Crown Corporations and Other Corporate Interests of Canada*, which is required to be tabled not later than 31 December 1997. (Not tabled at time of going to press.)

As required by subsection 152(2) of the *Financial Administration Act*, I have audited the information contained in the President of the Treasury Board's report on tablings for the year ended 31 July 1997. Further, I am required to report on this audit in my annual Report to the House of Commons.

I conducted my audit in accordance with the standards for assurance engagements established by the Canadian Institute of Chartered Accountants. Those standards require that I plan and perform an audit to obtain reasonable assurance as to whether the report on tablings is free of significant misstatement. My audit included examining, on a test basis, the systems and procedures used by the Treasury Board Secretariat to monitor the tabling of the summaries and annual reports in each House of Parliament, and the information contained in the report. Accordingly, it included such tests and other procedures as I considered necessary in the circumstances.

In my opinion, the information contained in the report on tablings is accurate in all significant respects in accordance with the description of the Deadlines for Tablings in Parliament disclosed in the report.

The following paragraphs are intended to highlight certain information that I believe may be of interest to members of the House of Commons.

This year's report on tablings identifies 38 instances of documents that were tabled late, relating to 15 of 37 Crown corporations required under the *Financial Administration Act* to table reports in the year. The report does not, however, identify that the 1995 Capital Budget Summary Amendment for Laurentian Pilotage Authority has not yet been tabled in either House of Parliament (deadlines were 22 April 1996 for the House of Commons and 12 June 1996 for the Senate).

Further, although not technically required to be disclosed in the report on tablings, the corporate plans of Atomic Energy of Canada Limited for 1995–96 to 1999–2000 and 1996–97 to 2000–01 have not, as required by subsection 122(1) of the *Financial Administration Act*, been approved by the Governor in Council. As a result, corporate plan summaries for these periods have not been tabled in either House of Parliament.

Assistant Auditor General
for the Auditor General of Canada

Ottawa, Canada

3 October 1997

#### **APPENDIX E**

## The Costs of Crown Corporation Audits Conducted by the Office of the Auditor General of Canada

Section 147 of the *Financial Administration Act* requires that the Office disclose the costs of preparing audit reports on all Crown corporations other than those exempted under section 85 of the Act (see Exhibit 1). An audit report includes an opinion on a corporation's financial statements and on its compliance with specified authorities. It may also include reporting on any other matter deemed significant.

The Office is also required by section 68 of the *Broadcasting Act* to report the cost of any audit report on the Canadian Broadcasting Corporation. For the fiscal year ended 31 March 1997, the full cost of the annual audit report was \$439,982.

Section 138 of the *Financial Administration Act* requires that, at least once every five years, each parent Crown corporation named in Schedule III of the Act undergo a special examination. This is distinct from the requirement for the annual audit of financial statements.

The objective of a special examination is to determine whether a corporation's financial and management control and information systems and its management practices provide reasonable assurance that:

- assets have been safeguarded and controlled;
- financial, human and physical resources have been managed economically and efficiently; and
- operations have been carried out effectively.

In 1996–97 the Office completed the special examination of Petro–Canada Limited and the cost was \$21,190.

Exhibit 1

Costs of Preparing Annual Audit Reports for Fiscal Years Ending on or before 31 March 1997

Crown Corporation	Fiscal Year Ended	Cost Incurred
Atlantic Pilotage Authority	31.12.96	\$ 60,008
Atomic Energy of Canada Limited (Joint Auditor)	31.03.97	248,549
Business Development Bank of Canada (Joint Auditor)	31.03.97	211,400
Canada Deposit Insurance Corporation	31.03.97	184,321
Canada Development Investment Corporation (Joint Auditor)	31.12.96	33,949
Canada Lands Company Limited (Joint Auditor)	31.03.97	98,958
Canada Lands Company (Vieux-Port de Québec) Inc.	31.03.97	6,130
Canada Mortgage and Housing Corporation (Joint Auditor)	31.12.96	288,725
Canada Museums Construction Corporation Inc.	31.03.97	9,432
Canadian Commercial Corporation	31.03.97	103,645
Canadian Dairy Commission	31.07.96	125,987
Canadian Museum of Civilization	31.03.97	76,218
Canadian Museum of Nature	31.03.97	91,392
Cape Breton Development Corporation	31.03.97	299,692
Defence Construction (1951) Limited	31.03.97	31,749
Enterprise Cape Breton Corporation	31.03.97	79,581
Export Development Corporation	31.12.96	333,653
Farm Credit Corporation	31.03.97	318,696
Freshwater Fish Marketing Corporation	30.04.96	85,657
Great Lakes Pilotage Authority, Ltd.	31.12.96	61,369
Laurentian Pilotage Authority	31.12.96	86,363
Marine Atlantic Inc. (Joint Auditor)	31.12.96	181,962
National Capital Commission	31.03.97	193,838
National Gallery of Canada	31.03.97	64,036
National Museum of Science and Technology	31.03.97	57,185
Old Port of Montreal Corporation Inc.	31.03.97	75,115
Pacific Pilotage Authority	31.12.96	47,689
Petro-Canada Limited	31.12.96	18,181
Queens Quay West Land Corporation	31.03.97	26,411
Royal Canadian Mint	31.12.96	310,206
The St. Lawrence Seaway Authority	31.03.97	112,519
Seaway International Bridge Corporation Ltd.	31.12.96	49,800
The Jacques Cartier and Champlain Bridges Incorporated	31.03.97	71,928
Standards Council of Canada	31.03.97	38,458
VIA Rail Canada Inc. (Joint Auditor)	31.12.96	214,040

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Sustainable Development Strategy for the Office of the Auditor General



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# Report of the Auditor General of Canada to the House of Commons

Chapter 37
Sustainable Development Strategy for the
Office of the Auditor General

December 1997





Report of the Auditor General of Canada to the House of Commons

Chapter 37
Sustainable Development Strategy for the
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This December 1997 Report comprises 16 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, October and December 1997 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Deputy Auditor General: Michael J. McLaughlin Responsible Auditor: Gisèle Grandbois

# Sustainable Development Strategy for the Office of the Auditor General

#### **Main Points**

- 37.1 This is the Office of the Auditor General's (OAG) first sustainable development strategy. It tells parliamentarians how we intend to integrate environmental and sustainable development considerations into our business as a legislative audit office, and how we will measure our success in doing so.
- 37.2 This Office has a long history of involvement in environmental and sustainable development issues. In particular, over the past decade it has been a leader in conducting audits related to the environment. The *Auditor General Act* was amended in December 1995 to formally incorporate environmental and sustainable development issues into our mandate. The Commissioner of the Environment and Sustainable Development was appointed by the Auditor General in 1996.
- 37.3 Our sustainable development strategy encompasses the three core dimensions of our activities: our audit operations, our day-to-day operations, and our human resources. The sustainable development goals for our audit work are to promote sustainable development by:
  - providing advice and information to parliamentarians and members of territorial legislative
    assemblies to help them consider the environmental and sustainable development consequences of
    their legislative and oversight work;
  - supporting federal and territorial organizations in their efforts to integrate environmental and sustainable development considerations into their decision making for policies, programs and operations;
  - providing a means for Canadians to draw environmental and sustainable development concerns to the attention of the Government of Canada.
- Another goal we have is to minimize the negative environmental impacts of our day-to-day operations. Finally, we wish to support activities that recognize our employees as our greatest assets in pursuing our sustainable development goals.
- 37.5 Our strategy is action- and results-oriented: for each of our sustainable development objectives, we have identified the specific actions we need to take and have developed performance indicators that will help us monitor our progress toward achieving our goals and objectives.
- 37.6 The most pressing environmental and sustainable development issues facing government today cut across departmental mandates and political jurisdictions. Auditing these horizontal and cross-jurisdictional issues represents a challenge of integration and co-ordination for our audit teams as well as an opportunity to broaden our perspective.
- 37.7 Departmental sustainable development strategies represent a very important new tool for federal organizations. In addition to monitoring their progress, we will help strengthen the capacity of these organizations to build better strategies and implement them. Similarly, the petition process will create a more direct link with Canadian citizens wishing to express their concerns about the environment and sustainable development.
- **37.8** Globally, we believe we can make a difference in the quality of Canada's environment, and in its prospects for sustainable development.

Exhibit 37.1

Sustainable Development Goals and Objectives and Key Performance Indicators for the OAG

Sustainable Development Goals	Sustainable Development Objectives	<b>Key Performance Indicators</b>
OUR AUDIT WORK:  To promote sustainable development by:  providing advice and information to parliamentarians and members of territorial legislative assemblies to help them consider the environmental and sustainable development consequences of their legislative and oversight work;  supporting federal and territorial organizations in their efforts to integrate environmental and sustainable development considerations into their decision making for policies, programs and operations;  providing a means for Canadians to draw environmental and sustainable development concerns to the attention of the Government of Canada	<ul> <li>To incorporate environment and sustainable development as an integral part of our audit work</li> <li>To monitor the extent to which federal and territorial organizations have met the objectives and implemented the action plans set out in their sustainable development strategies</li> <li>To help strengthen the capacity of federal organizations to manage environmental and sustainable development issues</li> <li>To monitor the replies by departments to petitions made by Canadians about environmental and sustainable development concerns</li> </ul>	<ul> <li>% of parliamentarians who feel that our work has helped them – who better understand sustainable development issues and who use our chapters</li> <li>% of OAG references in the House of Commons and the Senate that were about environmental and sustainable development issues</li> <li>Number of federal organizations that improved their environmental and sustainable development reporting and performance</li> <li>% of our recommendations related to environment and sustainable development on which satisfactory progress was made</li> </ul>
OUR ADMINISTRATIVE ACTIVITIES: To optimize the use of natural resources and to minimize the negative environmental impacts of the OAG's day-to-day operations	<ul> <li>To complete and implement our Environmental Management System (EMS)</li> <li>To reduce paper and paper product consumption</li> <li>To increase the "greenness" of our purchases</li> <li>To reduce energy and water consumption</li> <li>To maximize the capture of recyclable material / To reduce waste production</li> <li>To encourage the use of environmentally responsible transportation for our audit work whenever it is time-efficient / To encourage the use of teleconferencing</li> </ul>	<ul> <li>Quantity of paper consumed per employee per year</li> <li>% of products stocked that are Ecologo products</li> </ul>
OUR HUMAN RESOURCES: To support activities that recognize our employees as our greatest assets in pursuing our sustainable development goals	<ul> <li>To enhance the capacity of OAG staff to recognize and integrate sustainable development related issues into their audit work</li> <li>To increase OAG staff awareness and practice of sustainable development efforts in the Office's day-to-day operations and society at large</li> </ul>	<ul> <li>Self-assessment of staff ability to recognize sustainable development-related audit issues</li> <li>% of staff who participated in sustainable development training sessions</li> </ul>

# Why a Sustainable Development Strategy for This Office?

#### What do we mean by sustainable development?

- 37.9 By sustainable development, we mean "development that meets the needs of the present without compromising the ability of future generations to meet their needs." (World Commission on Environment and Development, *Our Common Future*, 1987)
- **37.10** Sustainable development is a constantly evolving concept based on the integration of social, economic and environmental concerns into the activities of private or public organizations.
- 37.11 Progress toward sustainable development requires an integrated approach to planning and decision making that involves evaluating economic and social solutions on the basis of their effects on the environment and natural resources, and ecological solutions on the basis of their effects on the economy and society.

#### The Auditor General Act and A Guide to Green Government

Following the amendments made to the Auditor General Act in December 1995, 24 federal departments and agencies are required to table sustainable development strategies in the House of Commons by 15 December 1997. The amendments to the Act also call for the Commissioner of the Environment and Sustainable Development, who was appointed by the Auditor General in 1996, to review the departmental strategies. A Guide to Green Government, which was published at the time the amendments were made, presents key elements that departments should consider when preparing their strategies and suggests a way to develop and structure them.

37.13 This Office is not among the 24 federal organizations required to prepare a sustainable development strategy. However, given that sustainable development strategies are an extremely valuable planning tool for nearly all private or public organizations, we have decided to develop our own strategy and to table it in the House of Commons before 15 December 1997.

#### What our sustainable development strategy is ...

- **37.14** Our sustainable development strategy is designed to be comprehensive, results-oriented and developed through consultation:
- comprehensive because it covers the environmental and sustainable development aspects of our audit work and our day-to-day operations;
- results-oriented because we have identified the actions we need to take and the indicators we will use to judge performance toward each of our sustainable development objectives;
- developed through **consultation** because we have conducted an extensive communication and consultation campaign within the Office and with all our clients. These different points of view were extremely useful to us (see appendices A and B).
- 37.15 Sustainable development is not a new concept for the Office. We have been taking environmental and sustainable development issues into account in our audits for more than 10 years. Similarly, the environment and sustainable development are one of the Office's five priorities for 1996-2001. Creating the position of the Commissioner of the Environment and Sustainable Development and establishing his team in 1996 confirms the importance that Parliament and the Office attach to these issues.

Sustainable
development
recognizes the
importance we attach
to a healthy
environment, to a
prosperous economy
and to issues of equity
and fairness. The goal
is to take care of
people and, at the
same time, the
environment that
supports them.

We have been taking environmental and sustainable development issues into account in our audits for more than 10 years.

#### ... and what it is not

- **37.16** Our sustainable development strategy is not a substitute for the regular selection process for the audits we conduct.
- Our objective is not to have environmental and sustainable development issues supersede other significant matters but rather to strike the right balance among the various issues that are important to Canadians.
- The purpose of the sustainable development strategy and the upcoming

environmental management system is not to create new systems or impose new inflexible processes. In both cases, existing systems will be used.

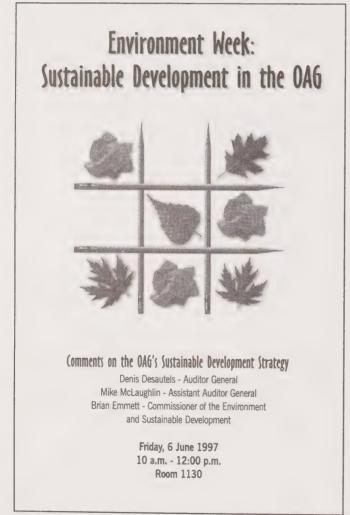
• The strategy does not provide answers to all our questions and does not present guidelines on how we will integrate environment and sustainable development into our audit work. This will be achieved through the implementation of our action plan.

#### For whom is this strategy intended?

- **37.17** The Office's sustainable development strategy is intended for four main groups:
- Members of Parliament, who are our main clients and who can hold the government to account for the way it takes sustainable development into account in its decision making.
- Our staff, on whom the implementation of this strategy depends. They must be comfortable with the strategy and be able to relate to it.
- Federal government employees and managers, with whom the Office maintains very close contact and who are responsible for integrating sustainable development issues into the policies, programs and operations of federal organizations.
- Canadians, whom the members of Parliament represent and for whom all this Office's staff and government employees work.

#### What will you find in this document?

37.18 If you have time to read only one page of this document, Exhibit 37.1 on page 37–6 will provide you with the essence of the strategy. It sets out our sustainable development goals and objectives and the key performance indicators. If you have a little more time, Appendix C will provide you with an overview of the action plan and the



June 6 1997: One of the many information sessions and roundtables on our sustainable development strategy (paragraph 37.14)

performance indicators that were developed for the Office.

37.19 If you read more of the document, you will learn about the Office's profile (below), the sustainable development issues associated with our activities (page 37–12) and how we developed our goals, objectives and action plan (page 37–16). Our conclusions are presented on page 37–20.

## What Are the Office's Mission and Activities?

#### **Our Mandate**

#### **Enabling legislation**

37.20 The Auditor General Act, the Financial Administration Act and a variety of other acts and orders-in-council set out the duties of the Auditor General and the Commissioner of the Environment and Sustainable Development as they relate to legislative auditing and monitoring of federal departments and agencies, Crown corporations and other national and international organizations.

#### Independence from government

37.21 We are different from departments and agencies by virtue of our independence from the government of the day and our reporting relationship to Parliament. Our independence is assured by a broad legislative mandate, freedom from certain controls over our budget and staff, and a 10-year term for the Auditor General. The first independent Auditor General was appointed in 1878.

#### The Office's Vision, Mission and Priorities

#### Strategic framework

**37.22** The Office's Strategic Framework reflects a number of areas where we intend to focus our efforts to meet new and greater challenges and to

make our Office an even better and more satisfying place to work. The strategic framework is currently being reviewed to incorporate, among other things, the elements of environment and sustainable development. Our Vision and Mission Statement guide our work:

Vision: We are committed to making a difference for the Canadian people by promoting, in all our work for Parliament, answerable, honest and productive government that reflects a commitment to sustainable development.

Mission: The Office of the Auditor General of Canada conducts independent audits and examinations that provide objective information, advice and assurance to Parliament. We promote accountability and best practices in government operations.

#### Office priorities

37.23 Many parties inside and outside government share a commitment to good government, and it is often through their co-operation and participation that we effect change. We assess our own effectiveness in terms of our ability to conduct high-quality audits that address significant topics and contribute to making a difference. Our five priorities for 1996-2001 are:

- To help improve the government's financial condition.
- To stimulate real advances in accountability concepts.
- To influence the quality of financial management.
- To contribute to necessary changes in the public service.
- To implement fully the role of the Commissioner of the Environment and Sustainable Development.

#### **Our Activities**

#### Legislative auditing

37.24 The principal activity of the Office is *legislative auditing*. Put simply, the Auditor General provides his professional opinion on the following questions:

Types of audits conducted and monitoring activities	Provides interested parties with answers to the following questions:
Attest audits of the Financial Statements of the Government of Canada	Is the government presenting fairly its overall financial situation?
Financial annual audits of Crown corporations, federal departmental corporations and other federal entities, territorial governments and organizations, other Canadian entities and international organizations.	Are Crown corporations, federal departmental corporations and other federal entities, territorial governments and organizations, other Canadian entities and international organizations presenting their financial information fairly and complying with relevant legislative authorities?
Value-for-money audits of departments and agencies	Were departmental and agency programs run economically and efficiently, and with regard to their environmental effects? Does the government have the means to measure the effectiveness of programs? Is legislation complied with and the public purse protected?
Special examinations of Crown corporations	Do systems and practices of Crown corporations provide reasonable assurance that assets are safeguarded, resources are managed economically and efficiently, and operations are carried out effectively?
Environment and sustainable development monitoring activities	To what extent did departments meet the objectives and implement the plans set out in their sustainable development strategies laid before the House of Commons?

#### The Commissioner of the Environment and Sustainable Development

37.25 The Commissioner of the Environment and Sustainable Development has been a major new responsibility within the Office since 1996. The amendments to the *Auditor General Act* require departments to prepare sustainable development strategies and action plans for tabling in Parliament by the responsible minister. Ministers are also required to respond within 120 days

to petitions from the public related to sustainable development issues.

**37.26** Four objectives will guide the work of the Commissioner over the next two years:

• To provide objective, independent analysis and recommendations to members of Parliament to help them examine the government's environmental and sustainable development activities and hold the government to account.

- To work with federal departments and agencies to help strengthen their capacity to manage environmental and sustainable development issues.
- To address both environmental protection and sustainable development, by emphasizing better decision making within the federal government.
- To continue to focus on key weaknesses in the federal government's management of sustainable development issues identified in previous work by the Office of the Auditor General, and on the success and failure of departments to deal with them.

#### Reporting to Parliament

37.27 The Auditor General tables his annual report and two periodic reports each year in the House of Commons. The Commissioner, on behalf of the Auditor General, is to report annually to the House on the extent to which departments have met the objectives and implemented the plans set out in their sustainable development strategies. Our work is also reported in other places and forms, according to enabling legislation. Our reports, as well as other information concerning the Office, are accessible on our Internet site at http://www.oagbvg.gc.ca.

#### **International activities**

37.28 We contribute to the development and dissemination worldwide of international standards, best practices and training programs in various areas of accounting, auditing and reporting through our involvement in the International Organization of Supreme Audit Institutions (INTOSAI), in the Panel of External Auditors of the United Nations, and in the audit of UN organizations. We also manage a fellowship program for senior auditors from national audit offices of developing nations. Finally, we audit the international activities of Canadian federal departments and agencies.

#### **Our Resources**

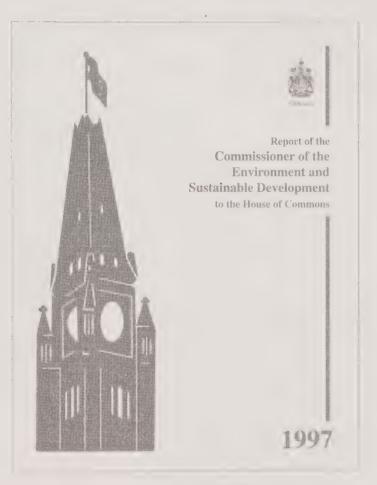
#### Organization of the Office

37.29 The Office is organized into three branches: Executive, Corporate Services and Audit Operations, which includes the team of the Commissioner of the Environment and Sustainable Development. Most of the audit staff work out of the head office in Ottawa. Regional offices are located in Vancouver, Edmonton, Winnipeg, Montreal and Halifax.

#### Resources

**37.30** The Office staff is multi-disciplinary: 50 percent are qualified accountants and another 10

The Commissioner reports annually to the House on the extent to which departments have met the objectives and implemented the plans set out in their sustainable development strategies.



The first Report of the Commissioner of the Environment and Sustainable Development (paragraph 37.27)

In our audit work, we will ensure that when we examine significant matters, we consider the issues identified by the departments in their strategies.

percent have postgraduate degrees in other disciplines, including engineering, law, statistics, sociology, history, the environment and economics. For 1996–1997, the Office's financial resources are \$50.1 million and the human resources are 520 employees.

## How Can This Office Affect Sustainable Development?

#### **Issues Associated with Our Audit Work**

Where can we have an influence on sustainable development?

37.31 The Office has a special status within the government. Unlike departments, it does not develop policies and does not manage programs. Instead, its role is to determine whether the government's programs and policies are administered in a responsible, honest and productive manner. The environmental and sustainable development issues to which we can draw attention, therefore, are the issues faced by the government departments and organizations we audit (see Exhibit 37.2).

37.32 There are various facets to our audit work (see page 37–10 for more details on our activities). The extent to which the Office can influence parliamentarians and federal departments and organizations in matters of the environment and sustainable development depends on the nature of our various audit products.

• During value-for-money (VFM) audits, we examine whether the departments and territorial governments took into account the effects of their policies, programs and operations on the environment and sustainable development. In the audits that begin after the tabling of the sustainable development strategies, we will ensure that when we examine significant matters, we consider the issues

identified by the departments in their strategies.

- Although it is not explicitly required by the *Financial Administration Act*, during **special examinations of Crown corporations** we determine whether the systems and practices in place are appropriate for sound management of the corporation's environmental activities. This determination depends on the types of activities the corporation is involved in and their potential impact on the environment.
- During **financial audits**, we determine whether environmental costs and liabilities were taken into account when preparing the financial information provided by the Government of Canada, the territorial governments, Crown corporations and certain entities, in accordance with the applicable accounting standards.
- Reviews of departmental sustainable development strategies will provide us with the opportunity to understand the environmental and sustainable development issues associated with each department's activities. As mentioned earlier, we will take these issues into account during our future value-for-money audits.
- The **petitions** submitted by Canadians will be another source of information to enable us to identify environmental and sustainable development issues that Canadians are concerned about.
- Finally, our **international activities** will help us raise awareness of environmental and sustainable development issues in the national audit offices of developing nations and in various international organizations.

#### Issues identified in our first Green Report

37.33 In the past decade, the Office has become increasingly active in the

#### Exhibit 37.2

#### Examples of Past OAG Audits Dealing with Environmental and Sustainable Development Issues



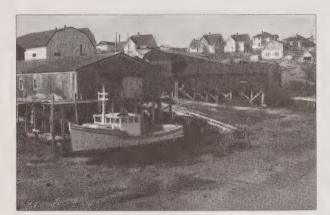
In April 1997, we reported on the transboundary movement of hazardous waste. In our opinion, as a result of the significant gaps in the areas of prevention, detection and enforcement and the limited facilities to physically control exports of hazardous waste at the border, Canada is not in a position to know the extent to which it is living up to its international obligations with regard to preventing illegal traffic at the border.

View of partially completed Confederation Bridge (to PEI). In an October 1995 audit of the planning and implementation phases of the bridge, we found that the requirements of the Environmental Assessment and Review Process were met and that there was provision for ongoing environmental protection and treatment of emerging problems during construction and operation.





Example of fish habitat damage: logging to stream edge. December 1997 audit on Pacific salmon management.



In our October 1997 audit of the management of Atlantic groundfish, we found that after spending over \$3 billion of new and reallocated funds to support the industry, including \$1.9 billion under The Atlantic Groundfish Strategy, the problems in the groundfish fishery remain. The fisheries management practices need to be further improved to ensure the sustainability of the resource base; dependency continues on the fishery to provide access to federal income support programs; and few employment alternatives exist for people in coastal communities.

Removal of soil contaminated by firefighting training at Canadian Forces Base Ottawa. In 1994, we recommended that departmental plans and budgets recognize all costs identified by departmental studies, and clear accountability be established for achieving all levels of environmental plans. (Photo courtesy of the Ottawa Citizen, Ottawa Canada)



Environmental and sustainable development issues evolve at the same pace as the societies that define them.

Identifying and examining horizontal issues also represents a challenge for the Office.

environmental arena and has been a pioneer in applying audit principles to the environment. The Office has conducted some 42 audits of matters that involved a key component related to the environment or sustainable development. A list of these audits is in Appendix D.

- 37.34 In his first report (March 1997), the Commissioner of the Environment and Sustainable Development identified three key themes stemming from the review of the federal government's performance in the management of environmental and sustainable development issues:
- the implementation gap between objectives and actions;
- a lack of co-ordination and integration; and
- inadequate review of performance and provision of information to Parliament.

We will continue to draw attention to these key weaknesses and to monitor departments' success in improving their practices.

#### Horizontal and cross-jurisdictional issues: the need for a global picture

37.35 Many of the most pressing environmental and sustainable development issues come under the jurisdiction of several departments and/or several levels of government. Because there is often a lack of co-ordination or integration among organizations, reviewing these horizontal issues poses a special challenge for governments.

37.36 For the Office of the Auditor General, identifying and examining these horizontal issues also represents a challenge in co-ordinating and integrating the work of various audit teams with that of the staff of the Commissioner of the Environment and Sustainable Development. Reviewing departmental sustainable development strategies will

provide an opportunity to focus on identifying and analyzing issues and problems common to various departments and agencies.

#### Adapting to change

- 37.37 Environmental and sustainable development issues evolve at the same pace as the societies that define them. It is essential for the Office to have the flexibility and vision needed to adapt quickly to these changes, or even to anticipate them. To do this, the Office has a range of tools and practices:
- information gathered from all our audits and from reviewing the departmental sustainable development strategies;
- a series of regional offices across Canada that act as the "eyes and ears" of the Auditor General in the field to identify issues in the provinces and territories;
  - petitions from Canadians;
- comments from our staff during consultations on the development and implementation of our sustainable development strategy;
- advice provided by the advisers to the Commissioner of the Environment and Sustainable Development, the members of the Auditor General's Panel of Senior Advisors and the members of our various advisory committees;
- regular meetings and consultations with our various clients and partners;
- seminars and work sessions with our provincial colleagues and colleagues from other national audit offices;
- new concepts and standards developed by various professional associations (for example, the standards for accounting for environmental costs and liabilities, developed by the Canadian Institute of Chartered Accountants).

#### Issues Associated with Our Day-to-Day Operations

The negative environmental impacts of our day-to-day operations are limited

37.38 The environmental impacts associated with the day-to-day operations of the Office are relatively limited. The Office has no laboratories, nor does it manage Crown land; it generates a very modest amount of purchases and has a one-car "fleet".

37.39 The issues associated with our day-to-day operations are therefore limited mainly to the following: changing our work and audit habits to help reduce our paper consumption; purchasing environmentally responsible products for our furniture and office supplies; recycling secondary materials; and optimizing travel for our audits. The Office is not the manager of the buildings it occupies, and does not have direct control over energy, water and waste management. We must therefore influence the managers of the

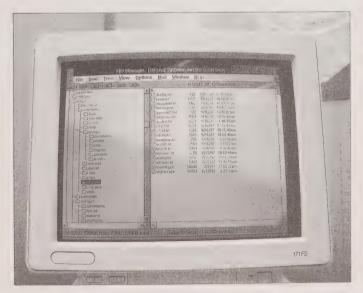
buildings we occupy to improve their environmental management.

37.40 With respect to the Office's human resources, the challenge is to continue to inform and train staff and management in the area of the environment and sustainable development. We must also look at the extent to which innovative work arrangements can reduce the energy costs associated with transportation and contribute to the well-being of employees. Finally, we must ensure that our internal policies are in keeping with our sustainable development objectives. The current parking subsidy, in particular, is not in keeping with these objectives.

#### How are we currently dealing with these issues?

37.41 The Office played a very active role in introducing electronic work tools: datebooks and mail, the Comprehensive Auditing Manual, methodological guides and reports, databases, timesheets, expense accounts, etc., all of which are available in electronic format. A pilot project currently under way is looking at

Double-sided printing and a good knowledge of electronic filing contribute to a reduction in paper consumption in the Office (paragraph 37.41)





possibilities for reducing the amount of paper required to document each financial audit. Most staff are in the habit of recycling materials, as indicated in an envirosurvey conducted internally in 1997. Similarly, purchasing policies take environmental considerations into account. However, these measures have not yet been systematically documented. Our environmental management system should be completed by the spring of 1998.

# Our Sustainable Development Goals and Objectives

Promoting sustainable development inside and outside this Office

**37.42** Exhibit 37.1 shows the sustainable development goals and objectives of the Office as developed in consultation with our staff, clients and partners. These goals and objectives are related to:

- our auditing activities, where we aim to promote sustainable development with our clients and partners;
- our day-to-day operations, where our aim is to promote sustainable development within our own organization;
- the management of our human resources, where we aim to encourage our staff to behave in such as way as to contribute to achieving all of our sustainable goals and objectives.

#### A long-term perspective

37.43 Generally speaking, the sustainable development goals that we have set for ourselves are in keeping with the results we would like to achieve in the medium or long term. The Office does not have control over these results (outcomes), but its activities may nevertheless have an impact on them and

may contribute to their achievement. Measuring long-term outcomes is often difficult, and evaluating the contribution of each stakeholder is always a sensitive matter. Despite these limitations, the examination of our performance in this regard should be a profitable learning exercise.

37.44 Sustainable development objectives generally correspond to short-or medium-term outputs that the Office controls directly through its various activities. These objectives must be measurable and closely related to the long-term goals to which they contribute.

#### Shared by all our staff

37.45 For an organization to achieve its objectives, two conditions must exist. First, senior management must have made a real commitment. Second, staff must "adopt" the proposed objectives and identify with the activities suggested for achieving them.

**37.46** Throughout the development of the Office's sustainable development strategy, constant attention was paid to these aspects. For example:

- the Auditor General showed his commitment to and interest in the issue of the environment and sustainable development;
- one of the two Deputy Auditors General actively directed the development of the strategy and chaired the Strategy Steering Committee;
- the Steering Committee, comprising senior managers representing the various activities of the Office, contributed directly to developing sustainable development goals and objectives and the major thrusts of the strategy;
- a working group comprising managers and professionals directly involved in audit work, in the Office's day-to-day operations and in human resources management developed the

Our employees are our greatest assets in pursuing our sustainable development goals.

action plan and the performance indicators for the strategy;

• through the many consultation activities, all staff were able to provide their input and were informed regularly of progress made on the strategy.

## Our Sustainable Development Action Plan

# **Linking the Goals and Objectives to Activities and Performance Indicators**

37.47 Appendices C.1, C.2 and C.3 summarize the Office's sustainable development action plan. These three tables were designed to highlight the links between our sustainable development goals and objectives (the results sought), the activities needed for achieving these objectives, and the results expected, illustrated with the help of performance indicators. The key indicators that will be used in our annual performance reports are presented in Exhibit 37.1.

#### Selecting the right mix of objectives/activities/indicators

37.48 The choice of sustainable development objectives and, subsequently, activities and performance indicators must reflect the priorities of an organization, the impact of its activities on sustainable development and the balance sought among the various functions/activities.

37.49 For this Office, the importance of audit activities is reflected in our objectives and action plan. The potential impact of our work on sustainable development is primarily a function of the influence we have on parliamentarians and federal organizations through our audit activities. Although the negative effects of our day-to-day operations on the environment are smaller than those of other departments, mitigating them is an important part of an overall strategy.

Finally, our objectives and our action plan have to highlight how the success of our strategy is directly related to the ability and commitment of our staff to carry it out.

#### **Implementing Our Action Plan**

37.50 As demonstrated by the high rate of attendance at discussion groups and response to the Envirosurvey, and by the comments gathered, most of our staff show a real interest in environmental and sustainable development issues. Further, the vast majority feel that the Office can influence the practices of Parliament and federal organizations in the area of sustainable development (70 percent said we can influence to a certain extent; 19 percent said we can influence significantly).

**37.51** Some of the necessary conditions for integrating environmental and sustainable development issues into our audit operations were discussed during the consultation activities:

- fully integrate the new team of the Commissioner of the Environment and Sustainable Development into the Office, and clearly define its role and its links with the audit teams;
- define the process that will help us address horizontal issues;
- facilitate the "lending" of environmental and sustainable development resources from one team to another;
- find the right balance between environmental and sustainable development issues and other potential lines of inquiry;
- provide the resources needed by audit teams in the medium term to examine environmental issues and review departmental sustainable development strategies;
- place as much importance on implementing the Office's strategy as on

The potential impact of our work on sustainable development is primarily a function of the influence we have on parliamentarians and federal organizations through our audit activities.

We will need to place as much importance on implementing the Office's strategy as on developing it.

As a result of the important environmental and sustainable development issues associated with the territories and departments audited by our regional offices, they will be fully involved in developing and implementing our strategy.

Auditors will be better able to identify environmental and sustainable development issues that constitute significant matters to be audited.

developing it, and allocate the necessary resources.

## Integrating our sustainable development strategy into the Office's operational processes

37.52 To have a real chance of being implemented, our sustainable development strategy will have to be integrated quickly into each of the Office's operating processes: strategic planning, development of methodology, budgeting and production of performance reports. The strategy will also be directly linked to our environmental management system.

#### Implementing our strategy fully in each regional office

The Office of the Auditor 37.53 General has five regional offices. In addition to departmental and Crown corporation auditing, some of these offices conduct financial audits and value-for-money audits for territorial governments. The governments of the Yukon Territory and the Northwest Territories are audited by our Western Canada offices, and the new Nunavut Territory, to be established in 1999, will be audited by our Montreal office. As a result of the important environmental and sustainable development issues associated with the development of these territories and with the departments audited by our regional offices, they will be fully involved in developing and implementing our strategy.

#### Working with our partners

37.54 Whether in Ottawa or in the regions, the Office is neither the manager nor the sole tenant of the building in which it is accommodated. It therefore has limited control over numerous aspects of its day-to-day operations. In Ottawa, the energy, water and waste in the C.D. Howe Building are managed by Public Works

and Government Services Canada. We will therefore work with that Department and the other tenants of the building to achieve some of the objectives of our strategy.

## Completing and implementing our environmental management system (EMS)

37.55 We should be able to finalize our environmental management system in the spring of 1998. Many measures were already in place by summer 1997, but the documentation system has not yet been completed.

#### What our sustainable development action plan will mean for our employees

The sustainable development action plan has implications for all our staff, particularly for training. Generally, all employees will have the opportunity to improve their knowledge of the environmental and sustainable development aspects associated directly with their work. Auditors will be better able to identify environmental and sustainable development issues that constitute significant matters to be audited (see Exhibit 37.3). The staff of the Corporate Services Branch will be better able to understand the environmental issues associated with the day-to-day operations they manage.

37.57 With respect to day-to-day operations, management would also like all employees to contribute to the objectives of the Office by reducing paper consumption, recycling secondary materials and optimizing the use of public transportation and opportunities for making conference calls.

37.58 The Office encourages its 520 employees to set an example through their behaviour in their auditing of departments and Crown corporations, and in their day-to-day activities at work or at home.

# Responding to a Challenge: Performance Measurement and Reporting

#### The question of attribution

37.59 We want to promote sustainable development among parliamentarians, federal organizations and Canadians in general. This is an ambitious goal that we share with a number of other stakeholders, making it difficult to evaluate the extent to which we will have contributed to achieving the desired result.

37.60 Nonetheless, while we cannot accurately specify our contribution to achieving these long-term goals, we can show a logical link between our activities and the results observed. This will be based on a series of indicators involving results associated with short- and medium-term objectives (outputs) and the changes observed in the longer term (outcomes), including changes in behaviour. Taken separately, none of these indicators is perfect. However, used judiciously, together they will enable us to evaluate our influence and our progress toward sustainable development.

#### Reporting on results: a process of continuous learning and improvement

37.61 Measuring performance is a process of ongoing improvement. In this first sustainable development strategy, we were able to identify performance indicators for each of our objectives. In our next progress reports (1998 and 1999) we will re-evaluate the relevance of each indicator, based on the quality and significance of the information gathered.

37.62 We were able to present reference data (at 1 April 1997 or summer 1997) for only some of the indicators. In several cases, the activity that we want to measure is a new one in the Office, as will be the case with the review of departmental sustainable development strategies starting in the winter of 1998. In the absence of

reference data, we did not identify a specific target. In the 1998 progress report, we plan to propose targets for most of the objectives.

#### What will we do with our performance measures?

37.63 As noted in paragraph 37.52, our sustainable development strategy will be integrated into the Office's management process and into our environmental management system. The follow-up to the

Exhibit 37.3

#### **Examples of Integrating Sustainable Development into Previous Audit Work**

"Environmental liabilities of the Government are likely quite significant. However, the Government has not recognized such liabilities in its financial statements because of uncertainties in defining and estimating them. I continue to hold the view that steps can and should be taken now to provide a more complete picture of environmental liabilities and costs in the financial statements."

(Public Accounts of Canada, 1997)

"In our 1992 Report, we indicated that Canada did not have a national legislative framework for land-based chemical accidents. Such a framework is still not in place."

(Chapter 35: Follow-up of 1992 audit on Emergency Preparedness in the Federal Government: Accidents Involving Oil and Chemicals, 1997, 35.15)

"When the Fraser River Action Plan was announced in June 1991, there had been little, if any, consultation with the Province of British Columbia, despite the fact that the province is an essential partner in the efforts in the efforts to clean up and restore the river. Such a lack of early consultation can inhibit timely action and program development by potential partners."

(Chapter 14: The Control and Clean-up of Freshwater Pollution, 1993, 14.68)

"Some projects had been approved and work begun before an environmental assessment was completed. Meeting the requirements for environmental protection means that departments must ensure that potential adverse effects and mitigating measures are identified before irrevocable funding decisions are made."

(Chapter 26: Infrastructure Works Program, 1996, 26.93)

"Is Canada's Constitution environmentally friendly? The Canadian Constitution says nothing about the environment. In several cases, the courts have been called upon to interpret how the Constitution's division of powers between the federal and the provincial governments applies to environmental issues."

(Chapter 18: Department of the Environment, 1990, 18.50-52)

Sustainable development is a journey, not a destination.

The main influence that our sustainable development strategy will have on the Office will be that we will approach our audit operations in a more integrated and comprehensive manner.

strategy will therefore be part of the Office's continuous improvement process. A report will be made to the Executive Committee twice a year. The Strategy Steering Committee, created while the strategy was being developed, will continue its activities to ensure that the Office's activities are adjusted on the basis of the performance achieved.

# **Looking Forward: Integrating Sustainable Development**

Who will review our strategy?

37.64 As with other departments and agencies, the Office's sustainable development strategy will be reviewed by the Commissioner of the Environment and Sustainable Development. The Commissioner's Panel of Environmental Advisors will also be asked to review the strategy.

#### Updating our strategy and performance indicators

37.65 We plan to follow the same process as other departments. Thus, within three years of first tabling our strategy we will update it. Similarly, we will prepare an annual progress report showing how we have improved our performance in issues of the environment and sustainable development, and whether we have achieved our targets.

37.66 We will integrate this information into the Office's Performance Report submitted annually to the Treasury Board. The key indicators identified in Exhibit 37.1 will be used for this purpose.

#### What are the aspects we will need to improve in our strategy?

**37.67** At the end of a process such as the development of this strategy, it is often difficult to step back far enough to

evaluate weaknesses. However, we already know that at least three aspects will need to be improved when our strategy is updated. First, we will begin the consultation process with our clients and partners earlier so that they can more fully influence the development of our strategy rather than react to our proposals. Second, the broader availability of reference data will allow us to identify specific targets for our objectives. And third, we will need to pay more attention to the social dimension of sustainable development.

#### How is our strategy going to influence our work in the years to come?

37.68 The main influence that our sustainable development strategy will have on the Office will be that we will approach our audit operations in a more integrated and comprehensive manner. Greater attention will also be paid to the horizontal issues that cut across departmental mandates, cross political jurisdictions and even go beyond our national borders.

## How will our strategy influence our relationship with Parliament, federal organizations and Canadians?

37.69 The Office's role in the sustainable development strategy process is proactive, not reactive. This means helping parliamentarians and members of territorial legislative assemblies consider the environmental and sustainable development consequences of their legislative and oversight work. It means supporting federal and territorial organizations in their efforts to integrate environmental and sustainable development considerations into their decision making for policies, programs and operations. And it means providing a mechanism for Canadians to draw environmental and sustainable development concerns to the attention of the Government of Canada.

#### **Appendix A**

#### **Strategy Team**

#### **Core Team Members**

Sylvie Cantin Lori Elliott Paul Fowlow Adriel Gionet Gisèle Grandbois Rita Gudziunas–Mankowski Ginger Stones

#### **SDS Regional Co-ordinators**

Francine Bissonnette Kevin Potter Geoffrey Robins

Forty percent of our employees contributed to the development of our strategy by organizing or participating in roundtables, sending comments, providing technical or professional support, or by acting as technical advisors.



#### Appendix B

#### **Summary of Consultation Activities**

Our strategy was developed in close consultation with our employees and clients. The structure for managing this initiative, the information and consultation activities carried out, the results obtained and, finally, the integration of the comments gathered throughout the process illustrate how we went about it.

#### 1. How did we prepare our sustainable development strategy?

- The Strategy Management Committee, chaired by the Deputy Auditor General responsible for the Corporate Services Branch, consisted of 11 managers representing the various groups in the Office. This committee was responsible for the overall thrust of the strategy and its oversight. It met nine times over five months and will continue to meet regularly during the first year the strategy is implemented.
- The strategy production "team" consisted of the co-ordinator and five experienced professionals and managers directly involved in operations involving audit, administrative management, professional development and communicating performance information. The "team" was responsible for developing the action plan and the performance indicators. Its members met formally seven times, and there were also a large number of working meetings.
- Some 10 technical advisors from various teams in the Office, with a broad range of expertise in auditing, communicating performance information, relations with Parliament, communications, professional practice, strategic planning and environment were consulted at various stages in development of the Strategy.
- Three regional co-ordinators were identified early on, to facilitate participation of the regional office.

#### 2. Implementation of our consultation and communication plan

One of the very first activities in developing the strategy was the preparation of a consultation and communication plan. This plan showed which information and consultation activities were planned for the various groups concerned (staff, clients and partners), the messages to be conveyed and the timetable. In summary, the plan's major achievements are:

#### Internal consultation

- Creation of an electronic database (on Lotus Notes) presenting detailed and regularly updated information on
  development of the strategy: consultation and communication plan, agendas and minutes of Management
  Committee meetings, minutes of discussion groups, results of the survey on the environmental behaviour of
  employees and comments made by employees in this electronic survey, preliminary versions of the goals and
  objectives of sustainable development, etc.
- Official launch of the strategy in Ottawa and in each of the regional offices. In Ottawa, the Auditor General and
  the Deputy Auditor General responsible for this initiative took part in the launch, with some one hundred people
  in attendance. In each of the regional offices, this initial presentation was made by one of the Deputy Auditors
  General.
- Formation of 17 discussion groups set up to gather the views and comments of some 200 employees in Ottawa, Vancouver and Montreal on the goals and objectives of sustainable development in the Office (first phase of consultation) and on the performance indicators (second phase).

- Carrying out of a survey on the environmental behaviour of employees. 204 employees took part in this electronic survey (out of a possible 520) and more than 100 made comments in response to the questionnaire's three open-ended questions. This survey provided reference data for a number of the performance indicators in the action plan.
- Presentation of the final report on the strategy and discussion of its implementation at the annual employee information day and in connection with working sessions in each of the regional offices.

#### Consultation with clients and partners

Three main outside groups were consulted in developing our strategy:

- some 20 parliamentarians from among the members of the Standing Committee on the Environment and Sustainable Development and the Standing Committee on Public Accounts of the 35th Parliament, the Environment critics from the Opposition parties and the members of the Standing Senate Committee on Energy, the Environment and Natural Resources:
- some 20 deputy ministers, members of the Sustainable Development Co-ordinating Committee;
- the members of the Panel of Environmental Advisors to the Commissioner of the Environment and Sustainable Development.

These clients and advisors representing various viewpoints and interests in Canadian society were consulted twice. First we sought their comments on our initial version of the goals and objectives of sustainable development in the Office. Later we submitted to them the draft of our strategy report, including our action plan. In total, during the process, some 20 MPs, senators, deputy ministers or advisors passed their comments on to us, some of them during both phases of the consultation.

The general public also had an opportunity to voice their expectations about our strategy. Our website indicated that we were in the process of developing our sustainable development strategy and invited interested individuals and groups to send in their suggestions. As of mid-October, no comments from the public had been received.

Finally, our communication plan contains a number of initiatives aimed at making our partners aware of the various activities in our action plan. We are especially targeting managers and other occupants of the buildings in which our offices are located. These activities will take place in connection with the implementation of our strategy.

#### 3. Integrating the comments received into our strategy

The comments made in connection with the various communication activities were carefully collated. Hence, formal minutes were taken for all meetings of the Strategy Management Committee and nearly all the discussion groups. The comments expressed in the survey on environmental behaviour were compiled. The many draft documents commented on by members of management, technical advisors and staff members were carefully consulted and retained. All of these documents, together with the letters, Email messages and memos of telephone conversations with our clients and advisors provided us with food for thought at each stage in developing the strategy. We trust that this document faithfully reflects the spirit of the comments received.

# Appendix C.1: Our Action Plan for Our Audit Work

Sustainable development goals, Activities to achieve the objectives and targets	ectivities to achieve these objectives	Results achieved: performance indicators	
intended results)			
		Performance indicators	Baseline

- providing advice and information to parliamentarians and to members of territorial legislative assemblies to help them consider the environmental and sustainable development consequences of their legislative and oversight work;
- supporting federal organizations and territorial governments in their efforts to integrate environmental and sustainable development considerations into their decision making for programs and operations;
- providing a means for Canadians to draw environmental and sustainable development concerns to the attention of the Government of Canada

		Land of the control o	11011	the core minerical Commen	
Objective 1:	•	Connect environmental and SD issues to the budgeting system by using	•	Office expenditures on environmental and	,
To incorporate environment		distinct product and project numbers for these issues		sustainable development issues 1% of VFM	_
and sustainable development as	0	Develop guidelines for incorporating environmental and sustainable		expenditures (SP & Finance)	
an integral part of our audit		development issues into our audits and update the Comprehensive Auditing	•	Number of chanters ner vear related to	10 chs
work		Manual and the methodological guides (1998–99; Method. & SD)		environment and sustainable development (SD) (10/41	(10/41
(DAG Audit Op. Branch)	•	Integrate annimonmental and medicine by a large annimon by			1101
Madium town town		micelar chambental and sustainable development considerations into the	•	% of recommendations and observations	12%
to mointain andit		UAU strategic planning process (VFM audits selection, Strategic		related to environment and SD (SP & SD)	and ob
to maintain audit resources for		Framework, etc.)	•	Of of our recommendations related to	1001
environmental and sustainable	•	Continuous		ou our recommendations related to	17.01
development issues to an		continue working on the integration of the CESD team within the OAG and		environment and sustainable development on	55% si
adequate/balanced level (14 –		on the links with the other teams (CESD)		which satisfactory progress was made (SP and	-1661)
15% of total costs/year)	•	Define the process that will help us address horizontal issues and issues		all teams)	
Medium-term target:		raised by the petition process			
to have an adequate/balanced	•	Subject the integration process for environmental and sustainable			
coverage of environmental and		development issues to practice review (Baseline: March 98, follow-up:			
SD issues ( 10% – 15% of all		2000: Practice Development)			
OAG's observations and					
recommendations)					

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Note: Responsibility for achieving each objective, implementing each activity and evaluating each indicator is shown in parentheses.

VFM: Value-for-money auditing

MP: Member of Parliament

DG: Director General DM: Deputy Minister AG: Auditor General

SDS: Sustainable Development Strategy SP: Strategic Planning

Sustainable Development Parliamentary Liaison SD:

Professional Development Information Technologies HR: Human Resources

CESD: Commissioner of the Environment and Sustainable Development AAG: Assistant Auditor General

INTOSAI: International Organization of Supreme Audit Institutions PWGSC: Public Works and Government Services Canada IDI: INTOSAI Development Initiative

DAG: Deputy Auditor General

# Appendix C.1 (cont'd)

Sustainable development goals, objectives and targets	Activities to achieve these objectives	×	Results achieved: performance indicators	
(intended results)	t	P	Performance indicators	Baseline
Medium-term target:	Systematically consider environmental and SD issues in our audit work:	•	% of chapters and	
to increase the usefulness of our	- VFM: when deciding on audit scope;		% of special exams reviewed by the Practice	
reporting to Parliament	- Special exams: when deciding on important issues to examine;		Development team that integrated environmental and SD issues (Practice	
	- Annual audits: reporting of environmental costs and liabilities in		Development)	
	accordance with appropriate accounting standards	•	% of audit planning documents that considered	1
	Document systematically in new audits starting in 1998 the fact that environmental and SD issues were considered:		whether environmental and SD issues were significant audit matters (SD)	
	- VFM: in overview and survey reports;	•	% of parliamentarians who feel that our work	
	- Special exams: in the planning documents to advisory committee;		has helped them – who better understand issues and who use our chapters (SP)	
	- Annual audits: in checklist and planning memorandums	•	% of OAG references in the House of	8% of all OAG
	Develop for March 1998 an OAG survey to determine the satisfaction level	level	Commons and the Senate that were about	references (15/185)
	of MPs with the work of the OAG. The survey will be sent out at the beginning and at the end of a new Parliament (SP, PL & SD)		environmental and SD 1ssues (PL)	2.4 examiltae
	Through our international activities (especially activities such as INTOSAI	SAI	on environmental and SD issues using our	hearings (1996–97)
	and the IDI and Fellowship training programs), raise awareness of environmental and SD issues in the national audit offices of developing	bo (	chapters (SD)	
	nations and in various international organizations (international Alians)	(6		
	Work with provincial collegues to ensure that cross-jurisdictional issues are covered	s are		
	<ul> <li>Integrate environmental and SD reporting into OAG performance reporting (1997–98: SP)</li> </ul>	rting		

# Appendix C.1 (cont'd)

Sustainable development goals, objectives and targets (intended results)	Activities to achieve these objectives	Results achieved: performance indicators	
		Performance indicators	Baseline
Objective 2:  To monitor the extent to which federal organizations have met the objectives and implemented the action plans set out in their SD strategies (CESD) Short-term target: 100% compliance with the Auditor General Act	<ul> <li>Develop criteria for reviewing SDS and progress reports on the implementation of SDS and action plans (1997–98: SD and all teams)</li> <li>Inform organizations of OAG expectations with respect to SDS (1997–98: SD)</li> <li>Review the SDSs and include the observations in our reports (1998: SD and all teams)</li> <li>Review the progress reports on the implementation of SDS and action plans and include the observations in our reports (1999: SD and all teams)</li> </ul>	<ul> <li>% of organizations that prepared their SDS and progress reports as required (SD)</li> <li>For each of our criteria, percentage of SDS and progress reports that were very satisfactory/ relatively satisfactory/ont satisfactory (SD)</li> <li>% of objectives for which the organizations identified satisfactory performance indicators on outputs and outcomes (SD)</li> <li>% of objectives for which the organizations measured the results achieved in their progress reports, in relation to the indicators defined in the SDS (SD)</li> <li>% of objectives for which the measures of results presented in the organizations' progress reports showed an improvement (SD)</li> <li>Number of federal organizations that improved their environmental and sustainable development reporting and performance – significantly/to some extent/very little (SD and all teams)</li> </ul>	
To help strengthen the capacity of federal and territorial organizations to manage environmental and sustainable development issues (AG, DAGs and all AAGs) Short-term target: to increase the number of observations describing good practices in the management of environmental and SD issues Short-term target (2 years): Increase the number of federal organizations preparing SDS or reporting on SD using other means	<ul> <li>Develop appropriate tools to help organizations manage environmental and SD issues (SD)</li> <li>Identify and report on good practices in the management of environmental and SD issues (SD and all teams)</li> <li>Encourage large federal organizations that are not required to develop SDS to do so or to report on SD issues using other means (1998–99: Group 10, AAGs &amp; CESD)</li> <li>Develop for March 1998 an OAG survey to determine the satisfaction level of assistant DMs and DGs with the work of the OAG. The survey will be sent out a few months after the tabling of each AG periodic report (SP &amp; SD)</li> </ul>	Number of chapters/observations related to good practices in the management of environmental and sustainable development issues (SD)     Number of federal organizations that were not required to prepare SDS that did so or that reported on SD issues using other means (SD)     % of assistant deputy ministers and directors general who feel that our reports have helped them to better integrate sustainable development issues (SP)	(15 observations)

# Appendix C.1 (cont'd)

Sustainable development goals,	Sustainable development goals, Activities to achieve these objectives	Results achieved: performance indicators	
objectives and targets (intended results)		Performance indicators	Baseline
Objective 4: To monitor the replies by	Monitor the replies by departments to petitions (Starting March 1997:  CESD)  Decays a communication plan to ensure that Canadians know the role of the	Number of petitions received and % of petitions where the prescribed response delays were met by departments (SD)	(1996–97)
departments to pentions made by Canadians about environmental and sustainable development concerns	CESD (1997–98: SD and Communications)	• % of the OAG's coverage in the media (press) 4.3% after report tabling that involved environmental (30–700 mentions) and sustainable development issues (1996–97)	4.3% (30–700 mentions) (1996–97)
		% of activity on the OAG's website related to the Commissioner of the Environment and Sustainable Development and to the OAG's SDS (Communications)	CESD site opened March 1997

# Appendix C.2: Our Action Plan for Our Administrative Activities

Sustainable development goals, objectives and targets (intended results)	Activities to achieve these objectives	Results achieved: performance indicators	
		Performance indicators	Baseline
Goal: To optimize the use of natural res	Goal:  To optimize the use of natural resources and to minimize the negative environmental impacts of the OAG's day-to-day operations	o-day operations	¥ 1
Objective 1: To complete and implement our Environmental Management System (EMS)	complete and implement our environmental management system by     Spring 98 (Corporate Services Branch)		
(DAG Corporate Services Branch)			
Objective 2: To reduce paper and paper	adjust copiers to 2-sided defaults and continue to improve copiers' reliability (1997: Materiel)	Quantity of paper consumed per chapter and per employee <sup>1</sup> (Materiel)	113,000 sheets/
product consumption	explain to all staff how to adjust their network printers to print 2-sided as a		sheets/employee
(DAG Corporate Services Branch)  I-vear farget:	default (1997; IT)	Number of photocopies produced per chapter and per employee (Materiel)	69,418 copies/
reduce naner consumntion ner	• 10view current practices on reusing paper (1997–96)		conject employee
employee by 5%  I-year target:	<ul> <li>encourage use of electronic media and train everybody on how to do electronic filing (1997–98: IT &amp; PD)</li> </ul>	% of staff who usually:     – photocopy double-sided	(1996–97) 28%
to reduce the number of paper		- print double-sided	15%
forms by 15 %	<ul> <li>continue reviewing the audit documentation process (1997–98)</li> </ul>	· relise paper	, 330%
	<ul> <li>review all forms and reduce number of paper forms (1997–98: Materiel)</li> </ul>		51% (Enviro Survey July 1997)
		(to develop)  % of audit documentation in electronic format	-   122 paper forms
		Number of paper forms or % of forms in electronic format (Materiel)	(April 1997)

Consumption of paper refers to dual purpose paper (DP), the paper used for our photocopiers and network printers. Number of employees is a full-time equivalent (FTE)

# Appendix C.2 (cont'd)

opment goals, gets	Activities to achieve these objectives	Results achieved: performance indicators	
(intended results)		Performance indicators	Baseline
Objective 3:  To increase the "greenness" of our purchases (DAG Corporate Services Branch)	<ul> <li>Create a list of all stocked items, determine their "greenness" and identify other "green" options – Ecologo approval, recycled content and post-consumer recycled content, etc.— (1998: Materiel)</li> <li>Train staff involved in purchasing activities (1998: Materiel &amp; PD)</li> </ul>	(to develop – short-term)  % of products stocked that are Ecologo products % of products stocked that come from recycled material (Materiel)  (to develop – medium-term)  % of "green" furniture and equipment purchased (Materiel)	
Objective 4:  To reduce energy and water consumption (DAG Corporate Services Branch)	Meet and work with PWGSC property management and other building tenants to ensure that SD issues (energy and water consumption, waste management, air quality, materiel use) are addressed in all building maintenance activities and in the upcoming building refit (Facilities)	These indicators will be developed when planning the building refit. Right now, we have no way to measure our energy and water consumption	1
Objective 5:  To maximize the capture of recyclable material / Reduce waste production (DAG Corporate Services Branch)  Year 2000 target: Reduce waste by 50% using 1988 as base year ??	Encourage PWGSC to do annual waste audits (Facilities)	(to develop)     % of recyclable material that is recycled     % of our waste that is recycled     (to develop)     quantity of waste per employee	we don't have a baseline for 1988
Objective 6:  To encourage the use of environmentally responsible transportation for our audit work whenever it is time-efficient / to encourage the use of teleconferencing (not to the detriment of good co-ordination with our regional offices and clients)  (DAG Corporate Services Branch)	Enhance the quality and availability of teleconferencing facilities (1998     Telecommunications)	% of our audit work intercity travelling (downtown to downtown) that uses public transportation or car pooling (Finance)	1

Note: all education and awareness activities are presented in Appendix C.3 "Our Action Plan for Our Human Resources."

Appendix C.3: Our Action Plan for Our Human Resources

Sustainable development goals, objectives and targets		Activities to achieve these objectives	Results achieved: performance indicators	
(intended results)				
			Performance indicators	Baseline
To support activities that recognize our employees as our	nize o	our employees as our greatest assets in pursuing our sustainable development goals	als	
Objective 1:	•	prepare a competency model including environment and SD (1997; HR)	% of OAG employees who consider that they	A fair amount:33%
Enhance the capability of OAG staff to recognize and integrate sustainable development related issues into their andit work	•	prepare an electronic self-assessment tool including general environment and SD competencies (Fall 1997: HR)	know "a fair amount-quite a lot" in terms of SD knowledge (PD)	Quite a lot: 10% (EnviroSurvey, July 97)
(DAG Corporate Services Branch)	•	prepare an electronic self-assessment tool focussing on specific environment and SD competencies (1997–1998: HR, PD & SD)	self-assessment of "organizational SD effectiveness" and of "personal SD	
	•	develop a training plan to address SD competency gaps/needs of teams (1997–98; PD & SD)	effectiveness" (HR)	
			self-assessment of specific environment & SD	,
	•		knowledge (PD & SD)	
		integrate environmental and SD issues into their audit work (1998: PD, CESD & all teams)	% of staff who participated in SD training sessions (PD)	1
			self-assessment of ability to recognize SD-related audit issues (training session evaluations) (PD)	1
		•	% of OAG employees who believe that the Office's efforts in sustainable development could positively influence the practices of Parliament and federal organizations (PD)	to some extent: 70% to a significant extent: 19% (July 1997)

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Sustainable development goals, objectives and targets (intended results)	Activities to achieve these objectives	Resi	Results achieved: performance indicators	
		Perf	Performance indicators	Baseline
Objective 2: Increase OAG staff awareness and practice of SD efforts in the	design and administer an office-wide questionnaire (Envirosurvey) to establish current base of knowledge, attitudes and behaviours (July 1997: PD & SD)	•	% of employees who consider themselves to be actively committed in terms of environmentally sound behaviours (PD)	40% (July 1997)
Office's day-to-day operations and society at large (DAG Corporate Services Branch)	<ul> <li>present information sessions on different topics – e.g. OAG SD strategy, benefits of car pooling, green purchasing ((SD, PD &amp; teams)</li> </ul>	•	number of sessions held/ number of persons who attended (SD)	
Short-term target: one information activity every two months	<ul> <li>present SD tip of the month in 'quoi de neuf', Interim or other communication vehicle (Communications, SD and teams)</li> </ul>	•	% of employees currently taking advantage of alternative work arrangements, especially energy-efficient ones (HR)	23% compressed work week (120/520);
	encourage innovative work arrangements (HR)			4% part-time (20/520);
	• as part of the continuous review of the employee's compensation plan, eliminate the parking subsidy (1997–98: HR)			2 self-funded leave (1997)
	<ul> <li>encourage Treasury Board to replace the parking subsidy with a neutral compensation (1997–98: CESD)</li> </ul>	•	% of employees who car pool, park and ride, take the bus, walk or bike or rollerblade to work (PD)	72% (July 97)
	<ul> <li>encourage PWGSC management to install secure bike racks in C. D. Howe Building (1997–98: Facilities)</li> </ul>	•	number of new OAG bus users following pilot project	I
	contact regional transportation authorities to propose OAG as pilot project to increase ridership (1997–98)	•	number of registrations on the car pooling database (IT)	
	• create a database for car pooling for C.D. Howe Building's occupants (1997–98; ? & IT)	•	% of employees who take the stairs for short trips in most circumstances (PD)	47% (July 97)
	• create and display stickers in front of the elevators to encourage using the stairs (1997; Facilities)			

#### APPENDIX D

#### **Environmental and Sustainable Development Work by the Office, 1990 to 1999**

Reference	Title	Departments/Agencies	
1999	Promotion of the Mining Sector	Natural Resources Canada	
	Weather Services	Environment Canada	
	Sustainable Development Strategies	24 departments and agencies	
	Climate Change II	Environment Canada	
	Environmental Information	Environment Canada	
	Hazardous Material	National Defence	
	NAFTA – Environmental Impact	Revenue Canada	
	Enforcement in Ecosystem Management	Environment Canada	
	International Obligations: Developing Canada's Position		
	Managing for Sustainable Development		
	Accounting for Sustainable Development II		
	Ensuring a Sustainable Salmon Fishery	Fisheries and Oceans	
December 1998	Sustainable Fisheries: East Coast	Fisheries and Oceans	
May 1998	Sustainable Development Strategies	24 departments and agencies	
	Biodiversity Environment Canada		
	Meeting Our International Obligations		
	Public and Private Sector Performance		
	Performance Measurement		
	Accounting for Sustainable Development		
	Environmental Assessment	Environment Canada	
	Climate Change		
December 1997	Agriculture: Prairie Farm Rehabilitation Administration	Agriculture and Agri-Food Canada	
	Fisheries and Oceans: Pacific Salmon Management	Fisheries and Oceans	
	Environment Canada: Ozone Layer Protection	Environment Canada and 12 departments and agencies	
October 1997 Chapter 14	Fisheries and Oceans – Sustainable Fisheries Framework: Atlantic Groundfish	Fisheries and Oceans	
Chapter 15	Fisheries and Oceans: Rationalization and Renewal – The Atlantic Groundfish Strategy	Fisherieş and Oceans	
Chapter 16	Human Resources Development Canada – The Atlantic Groundfish Strategy	Human Resources and Development Canada	
April 1997 Chapter 4	Control of the Transboundary Movement of Hazardous Waste	Environment Canada	
Chapter 10	Natural Resources Canada: Energy Efficiency	Natural Resources Canada	
March 1997	First Report of the Commissioner of the Environment and Sustainable Development		

#### APPENDIX D (cont'd)

Reference	Title	Departments/Agencies	
November 1996 Chapter 22	Federal Contaminated Sites – Management Information on Environmental Costs and Liabilities	Treasury Board Secretariat, Environment, National Defence, Transport, Indian Affairs and Northern Development	
Chapter 26	Canada Infrastructure Works Program – Lessons Learned	Treasury Board Secretariat, Industry, Indian Affairs and Northern Development, Western Economic Diversification, Federal Office of Regional Development – Quebec, Atlantic Canada Opportunities Agency	
Chapter 31	Parks Canada: Preserving Canada's National Heritage	Heritage	
Chapter 39	Other Audit Observations – AECL	Atomic Energy of Canada Limited	
May 1996 Chapter 2	The Implementation of Federal Environmental Stewardship	Environment, all Departments	
Chapter 9	Animal and Plant Health: Inspection and Regulation	Agriculture and Agri-Food	
October 1995 Chapter 11	Environmental Management Systems: A Principle-Based Approach	Treasury Board Secretariat, Environment	
Chapter 15	Northumberland Strait Crossing Project	Public Works and Government Services	
May 1995 Chapter 2	Managing the Legacy of Hazardous Waste	Environment	
Chapter 3	Federal Radioactive Waste Management	Natural Resources, Atomic Energy Control Board	
1994 Chapter 9	Science and Technology – Overall Management of Federal Science and Technology Activities	Some Departments	
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